United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

76-7465

United States Court of Appeals

For the Second Circuit

TRANSCONTINENTAL OIL CORPORATION, TRECON OIL CO. LTD. and B. EDWIN SACKETT, individually and as nominee,

Plaintiffs-Appellees and Cross-Appellants,

—*against*—

TRENTON PRODUCTS COMPANY, BERNARD FEIN, HERZFELD & STERN, LOEB, RHOADES & CO., GERSTLEY, SUNSTEIN & COMPANY, A. ARTHUR WEISS, LOUIS C. FIELAND and THERESA ZAPPLEY,

Defendants.

TRENTON PRODUCTS COMPANY and BERNARD FEIN,

Defendants-Appellants and Cross-Appellees.

TRENTON PRODUCTS COMPANY and BERNARD FEIN,

Defendants and Third-Party Plaintiffs—Appellants and Cross-Appellees,

—*against*—

PHILLIP P. GOODKIN, LOUIS GOODKIN, MICHAEL A. ROBERTS, DAVID FRANKEL, JAMES E. DAVIS, PAUL A. ROSSBOROUGH, J. STREICHER & COMPANY, HARRY B. LESLIE, BERTRAM F. FAGENSON, EDWIN B. SACKETT and FAGENSON AND FRANKEL COMPANY, INCORPORATED,

dditional Defendants—Appellees on Counterclaim.

APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFFS-APPELLEES AND CROSS-APPELLANTS AND OF ADDITIONAL DEFENDANTS-APPELLEES ON COUNTERCLAIM

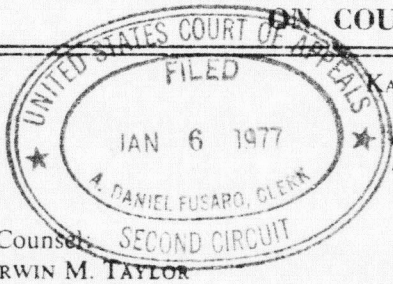

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TABLE OF CONTENTS

Table of Authorities

Statutes, Rules and Releases

Miscellaneous

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Preliminary Statement

Transcontinental Oil Corporation ("Trans") and B. Edwin Sackett ("Sackett"), individually and as nominee, are the plaintiffs—appellees and cross-appellants. This Brief is submitted on their behalf (a) in opposition to the appeal of Trenton Products Company ("Trenton") and Bernard Fein ("Fein")* from the final judgment entered by Hon. William C. Conner, District Judge herein, and (b) in support of their own appeal, as cross-appellants, from those portions of said judgment which dismissed:

(i) Count 1;

(ii) Count 9; and

(iii) That part of Count 10 as related to Trenton and Fein for their fraud and breach of warranty with respect to the amount of issued and outstanding stock of Trans.

This Brief is also submitted on behalf of the Additional-Defendants-Appellees on the Counterclaim in opposition to the appeal of Trenton and Fein from the dismissal of their counterclaims.

Counter-Statement of Issues

To the statement of issues set forth by the defendants, the plaintiffs add the following with reference to the subjects of their own cross-appeal:

1. Did the District Court err, as a matter of law, in finding that recovery of 450,000 shares of its stock which Trans claimed were converted by the defendants was barred by *res judicata*?

2. Did the District Court err in finding that plaintiff had failed to prove that the June 22, 1966 Agreement with Trenton and Fein provided for the sale of *all* of Trenton's shares of Trans stock?

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* Trans and Sackett are sometimes referred to herein as "plaintiffs" and Trenton and Fein as "defendants."

3. Did the District Court err in refusing to hold Trenton and Fein liable for breach of warranty with respect to the representation made by them as to the number of outstanding shares of Trans common stock as of the date of the Agreement between them and Sackett?

Upon the trial of the issues of liability, Judge Conner determined that Trans was entitled to recover its damages resulting from Fein's conversion of 100,000 shares of Trans stock (the so-called "Desilets Shares"). Upon the subsequent trial of the issue of the amount of damages, Judge Conner concluded that

> "... Trans may recover the amount of any proceeds received by Fein upon his sale of the Desilets stock to the extent such proceeds exceed forty-four cents per share." (A155)*

In addition, he computed damages at the rate of 44 cents per share for 30,000 shares, or a total of $13,200, plus $35,000 for the balance of 70,000 shares given by Fein to Fieland, for a total of $48,200 plus interest.

The foregoing determination by Judge Conner in favor of Trans thus granted relief to Trans upon Count 2 of the Complaint. Counts 1, 5, 6, 7, 9 and part of 10 were dismissed by the Court. It sustained only that part of Count 10 as charged a breach of warranty with respect to the status of certain gas leases. Counts 3 and 4 were withdrawn by Trans.

Upon this appeal, the plaintiffs press only their claims under Count 1 (for conversion of 450,000 shares), Count 2, Count 9 and only that part of Count 10, as indicated above, which relates to the breach of warranty by defendants with respect to the amount of issued and outstanding stock of Trans.

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* "A" denotes a reference to the Joint Appendix.

Counter-Statement of the Case

Judge Conner stated in his Opinion and Order dated July 31, 1975 that

> "As the record disclosed, Fein did convert 100,000 shares of Trans stock and had possession of hundreds of thousands of other shares whose origin were in such confusion that it required seven years of pre-trial discovery and a lengthy trial to unravel all the circumstances affecting their ownership."

Annexed to this Brief is a stock distribution chart, an enlarged copy of which was used upon the trial, to track the various changes of ownership and the movement of the shares from the time of their issuance until the time of the trial itself. From time to time, various witnesses made references to that chart and it is annexed here so that this Court of Appeals may have a frame of reference for such testimony.

The "Statement of the Case", as set forth by defendants, is substantially correct except that the Court's attention is respectfully directed to one grievous error. Defendants assert that the two shareholders' actions commenced by Sackett in 1965 were "in an attempt to take over control of Transcontinental, ..." (Defts'. Br. 2; also 8). There is simply nothing in the record which supports this outrageous suggestion. On the contrary, Sackett had been a stockholder of Trans since 1950 and made repeated efforts to obtain information about the company's affairs from Fein. His efforts met with very limited success. (Tr. 21-27, 35-38)* The thrust of his litigation was to compel Fein to call a meeting to stockholders and to provide them with a financial report (A, 173-4; 102). The number of shares owned by Sackett was obviously too few to make it possible for him to acquire control. It was only later, during the pendency of the litigation and its possible settlement, that both sides considered the transfer of control from Fein to Sackett (A 102; 188-9; Tr. 53-4).

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* References to the transcript of the minutes of the trial will be denoted by "Tr."

In one other respect, the Statement of the Case requires some clarification. Sackett directed the company's new transfer agent to stop the defendants from transferring their shares of Trans stock *not* "upon assuming control" and *not* as a mere incident of the assumption of that control, but only because the new transfer agent notified Sackett that it had discovered that there was a gross disparity between the number of shares warranted by Fein to be outstanding and the number of shares the transfer agent actually found to be outstanding. It was this discovery that triggered the issuance of the stop order affecting the transfer of certain shares of stock claimed to be owned by defendants. (Tr. 1366-9; Pl. Exs. 128, 95; Tr. 186-9)

Counter-Statement of the Facts

A. Corporate History

In 1960, Trans was a public corporation organized under the laws of the State of Delaware, with approximately 7,000 stockholders. Its shares were traded over-the-counter. It was esentially nothing more than a "shell" with virtually no operations and a very modest income. It had acquired a sixty-five percent working interest in the Rangely oil property in Colorado and it had five-eighths of the working interest in 18,775 acres of gas lease properties located in Sedalia, Alberta, Canada. The estimates of its proven reserves varied from eight to fifteen billion cubic feet, but its properties were not tied in with the Trans-Canada pipeline and no income was derived from that property.

Bernard Fein served without compensation as a director of the corporation from April 3, 1956 until August 12, 1966; as president from April 4, 1956 until November 30, 1959 and also from August 12, 1960 until August 12, 1966; as chairman of the Board of Directors from November 30, 1959 until August 12, 1966 (a position not provided for in the by-laws of Trans). One Orville V. Burkinshaw was president from November 30, 1959 until August 12, 1960. On or about October 1, 1959 1,000,000 shares of Transcontinental were issued to Anglo-Pacific. Burkinshaw was

president of Trans for the period between November 30, 1959 and August 12, 1960. (Pre-trial Order, A 53)

On October 10, 1960, Fein caused a letter to be sent to the shareholders of Trans together with an annual report of the status of the corporation (Pl. Ex. 72). That was the last communication from the management of Trans during the stewardship of Fein until the acquisition of control of Trans by Sackett on August 12, 1966. During that period of time, no annual meeting of the stockholders of Trans was called and no information was furnished to the body of stockholders.

B. Prior Litigation

As a result of the foregoing, two actions were commenced by Sackett on behalf of the stockholders of Trans, as follows:

a. An action in the District Court, bearing Docket No. 65 Civ. 2500, and entitled "B. Edwin Sackett, Plaintiff, against Transcontinental Oil Corporation, Bernard Fein, Roy L. Kropp, Leon M. Robinson and Trenton Products Company, Defendants" was commenced on August 24, 1965. The action was brought by said plaintiff, derivatively, on behalf of Trans and for its benefit, for alleged breaches by the named individual defendants and by Trenton of their fiduciary duties to Trans. The action was settled, after due notice to the stockholders of the corporation and a hearing thereon. An order and judgment was granted by Hon. H. R. Tyler, Jr. on July 12, 1966, approving the settlement as fair and adequate under the circumstances and directing the parties to proceed to its consumation in accordance with its terms. The settlement was based upon an agreement between Trenton, Fein and Sackett, dated June 22, 1966.

b. An application was made by Sackett, as a stockholder of Trans, in the Court of Chancery of the State of Delaware, New Castle County, for an order requiring an election to be held for the directors of Trans, said application having been granted on September 8, 1965. Pursuant to stipulation between the parties, the proceeding involving

the said application was dismissed with prejudice in October 1966 in connection with the settlement of the action in the District Court.

C. The Blocks of Stock Identified

On or about October 1, 1959 Trans made an agreement with Anglo-Pacific for the purchase of all of the outstanding stock of White River Exploration Company for 1,000,000 shares of the common stock of Trans and other consideration. Stock certificate A18912 for 1,000,000 shares was issued to Anglo-Pacific on or about February 5, 1960 (Pl. Exs. 1, 40b [mins. of Jan. 11, 1960], 84). Two months later, this certificate was exchanged by Anglo-Pacific for 9 certificates (A19616/24), each for 100,000 shares, and 2 certificates (A19625/6), each for 50,000 shares (Pl. Exs. 1-7, 61-67, 84). In April 1960, a tripartite transaction was entered into among Trans, Trenton and Anglo-Pacific, the net effect of which was to have Trans acquire a 5/8ths working interest in 13 petroleum and natural gas leases in the so-called Sedalia and Oyen gas field in the Province of Alberta, Canada. The transaction was financed by a loan made by Trenton in exchange for which Trenton received a note from Trans for $242,000 and there was authorized for issuance to it, by a resolution of the Trans Board of Directors, a block of 150,000 shares of Trans stock. In addition, Trenton agreed to sell to Anglo-Pacific 1/8th of the 5/8ths working interest in the Sedalia and Oyen gas fields which it had acquired as part of the transaction and, in consideration for the sale of this 1/8th working interest. Trenton was to be paid by Anglo-Pacific 150,000 shares of the Trans stock which Anglo-Pacific then owned (Pl. Exs. 8, 40b [mins. of Apr. 12, 1960]).

As the result of the foregoing transaction, therefore, Trenton would be the owner of 300,000 shares of Trans stock and Anglo-Pacific would be the owner of 850,000 shares of Trans stock.

In the belief that the original issue of 150,000 shares authorized for issuance to Trenton and represented by certificates A19527/56, dated April 25, 1960, were not "free" shares and, therefore, could not be readily trans-

ferred, Trenton requested and Fein agreed, on behalf of Trans, to have these 150,000 shares cancelled and, in their place, there should be delivered to Trenton 141,000 shares of treasury stock (the so-called "Brown" shares, of which 133,900 shares were identified and placed in evidence (Pl. Ex. 94) and, also, an additional 9,000 original issued shares to round out the total of 150,000 shares. Accordingly, a special meeting of the Trans Board of Directors on May 27, 1960 adopted the following amending resolutions:

> "With respect to the 150,000 shares that were authorized at special meeting of the Board of Directors on the 12th of April, the following amended resolutions were unanimously adopted:
>
> 2. RESOLVED, that the President or Chairman of the Board are authorized and directed to cause the issuance of 141,000 treasury shares and 9,000 shares of the authorized but as yet unissued shares of Transcontinental to Trenton Products Company, at the valued rate of 25¢ per share par value.
>
> 3. RESOLVED, that the President or Chairman of the Board execute any and all the necessary documents required to direct the Texas Bank & Trust Company as transfer agent of Transcontinental to issue such 9,000 shares and to transfer 141,000 shares (treasury) to the Trenton Products Company in the number of certificates as directed by the President or Chairman of the Board" (Pl. Ex. 40b).

The blocks of stock which were the subject of controversy in the First and Second Counts of the complaint may be identified as follows:

1. At the time of the adoption of the foregoing amending resolutions, it is indisputable that it was the intention of both Trenton and Fein, as well as that of the other directors, that the original issue of 150,000 shares, represented by certificates A19527/56, should be cancelled. Certainly, there was no consideration in favor of Trans for delivery to Trenton of more than 150,000 shares. The

intention to cancel certificates A19527/56 was expressly the testimony of Fein in his deposition and also upon the trial. In fact, for many years thereafter he was under the impression these shares had been cancelled (Tr. 655-63, 677, 633-4). For ease in further identification, these shares will hereinafter be referred to as the "*Trenton original issue shares.*"

2. As collateral security for its promissory note in the amount of $39,043.50, Anglo-Pacific delivered to Abraham M. Buchman, Esq., counsel for Trans, for transmittal to Fein, 200,000 shares of Trans stock (certificates A19622/3) and, shortly thereafter, an additional 300,000 shares (certificates A19616/18), making in all a total of 500,000 shares (Tr. 556-8). Upon default by Anglo-Pacific in the payment of the note, Fein claims that he gave notice of default and then notice of sale to Anglo-Pacific and proceeded to sell the 500,000 shares to Trenton at a price of 4¢ per share. This sale, it is conceded by these defendants, was deemed by them aborted and, instead, the same shares were subsequently sold by Trans to Trenton at a private sale on March 22, 1961 for 2¢ per share. No further notice was given to anyone of the second sale. It was entirely private and no one was then told of the sale nor was any other officer, director or stockholder ever subsequently advised of such sale. These shares will hereinafter be referred to as the "*collateral security shares.*" (Tr. 1007-8; Fein dep. pp. 250-1 264-5; 316; Pl. Ex. 118).

3. As consideration for the ⅛th working interest in the Sedalia and Oyen gas fields which it was acquiring from Trenton, Anglo-Pacific delivered to Trenton certificate A19620 for 100,000 shares and certificate A19625 for 50,000 shares. Upon receipt of such certificates, Trenton had them transferred, as of record, by Texas Bank & Transfer Company (then the Transfer Agent) for certificate A19620 for 100,000 shares and certificate A19625 shares. These shares bear the date of June 13, 1960 and will hereinafter be referred to as the "*Trenton-Anglo purchase shares.*"

4. By letter dated August 17, 1960, the Canadian attorneys for Anglo-Pacific, Messrs. Allen, MacKimmie, Matthews, Wood, Phillips & Smith, transmitted to Abraham M. Buchman, Esq., as attorney for Trans, certificates A20327 (150,000 shares), A19624 (100,000 shares) and A19621 (100,000 shares). This letter requested Mr. Buchman to forward one certificate to Trans' transfer agent for division to enable Mr. Buchman to return to the forwarding attorneys a certificate for 50,000 shares registered in the name of Anglo-Pacific. The remaining 300,000 shares were to be delivered by Mr. Buchman to Trans "in accordance with the terms of the Agreement between that Company and Anglo-Pacific Oil & Gas Ltd. dated August 12, 1960" Pl. Ex. 17). The foregoing 350,000 shares, represented by certificates A20327, A196624 and A19621, will be referred to henceforth, from time to time, as the "*August 12, 1960 Agreement shares.*"

Thus, it clearly appears that by August 17, 1960, Anglo-Pacific had divested itself of the possession of the 1,000,000 shares which it had originally received. This divestiture may be summarized as follows:

Collateral Security Shares (to Trans)	A19616/18; 19622/3	500,000 shs.
Trenton-Anglo Purchase Shares (to Trenton)	A19620; A19625	150,000 shs.
August 12, 1960 Agreement Shares (to Buchman for transmittal to Trans of 300,000 shares; 50,000 shares to be retained by Buchman in escrow)	A19621; A19624 and A20327 (formerly A19619 and A19626)	350,000 shs.
	TOTAL	1,000,000 shs.

Certificate A19621 for 100,000 shares was escrowed with Abraham Buchman, Esq., attorney for Trans and 50,000 shares thereof were eventually delivered by him to Sackett as part of the 650,000 shares sold by defendants on August 12, 1966. He retained the other 50,000 shares in escrow. Trans claims the difference between 950,000 shares and the 650,000 delivered to Sackett.

During the trial, on direct examination as well as on cross-examination, Fein testified that, on two separate occasion during 1960, Burkinshaw delivered to Green, for the benefit of Trenton, batches of Trans stock in response to the threat of Green to throw Trans into bankruptcy because of Burkinshaw's frauds (Tr. 561-2, 830-1). As will be more specifically set forth below, Fein was unable to identify the certificates that were allegedly sold and delivered by Burkinshaw to Green, which certificates eventually found their way into Fein's possession (Tr. 601, 603, 622-3, 844-849). Obviously, if Fein and Trenton came into the possession of the 1,000,000 shares of Anglo-Pacific (less the 50,000 shares escrowed with Buchman), as tabulated above, then these could not have been the shares which are claimed by Fein to have been delivered upon the threat of dire remedies being invoked by Green. The question which must then be considered is, if the testimony of Fein is to be believed at all, what shares were delivered to Green by Burkinshaw?

It could not have been certificate A19577 in the name of Jeanne Mason for 200,000 shares. This certificate was never part of Anglo-Pacific's 1,000,000 shares. As appears from Plaintiffs' Exhibit 13, Mr. Buchman received this certificate directly from the Texas Bank & Transfer Company. He testified it never was released to the registered owner (Tr. 1472-3, 854). He was still in possession of that certificate when Fein and Trenton surrendered control of Trans to Sackett and Sackett subsequently recovered the same for the benefit of Trans directly from Buchman. No claim has been made by Trans or by Sackett against Fein and Trenton for this certificate.

Certainly, certificates A19527/56, registered in the name of Trenton, for 150,000 shares never came into possession of Burkinshaw. No claim has been advanced by Trenton or by Fein that these certificates were ever in the possession of Burkinshaw or that they were or could have been delivered by Burkinshaw to Green in response to Green's threat against Trans and/or Burkinshaw.

Finally, there are the so-called "Desilets shares". The Court has already found these shares were the property of

Trans and were converted by Fein (Findings 32-35 at A 92-94, 121-124). These certificates were authorized on April 12, 1960 (Pl. Ex. 40b). Mr. Desilets testified that he knew of no reason why these certificates should have been authorized for issuance to him. He never knew of the transaction and he never saw the certificates until he appeared in Court during the trial. He saw copies of the certificates for the first time when he was deposed during the litigation (Tr. 477-8, 494). Mr. Buchaman testified that he had received these Desilets certificates from Texas Bank and Transfer Company on April 26, 1960 directly from the Texas Bank and Transfer Company (see Pl. Exs. 10, 13). Mr. Buchman testified further that he never delivered any stock certificates to Burkinshaw. Quite to the contrary, he testified that he delivered them to Fein (Pl. Ex. 13, Tr. 1474).

Fein testified that he never noticed any specific names on the certificates he claims he saw Burkinshaw deliver to Green. Moreover, when he eventually discovered that he was in possession of the Desilets certificates,—after he made his Agreement with Sackett, dated June 22, 1966,—he then found the Desilets certificates in one batch, not in two (Fein dep., pp. 100-117, 131-7, Tr. 831-4).

Recapitulating, the claim of Mr. Fein that the alleged transaction in which Burkinshaw delivered two batches of certificates to Green is wholly incredible. It was shown beyond dispute that both the mode of delivery of such shares and the purpose of such delivery were impossible because all the shares involved either went directly from the transfer agent (Texas Bank and Transfer Company) to counsel for Trans (Abraham M. Buchman, Esq.) and then from him to Fein, or were otherwise routed from counsel for Burkinshaw to the aforesaid corporate counsel for delivery to Fein in connection with other transactions that had nothing whatsoever to do with any reparations for alleged fraud. There were simply no shares which could have been delivered by Burkinshaw directly to Green for this purpose and Fein could not have witnessed such delivery. His testimony to that effect had to be a fabrication designed to support a claim that Trenton was the

rightful recipient of the shares of stock it wrongfully misappropriated and converted as well as withheld from Sackett in consummation of the Settlement Agreement of August 12, 1966.

The facts relating to each of the above-mentioned separate blocks of stock will be considered further in connection with the analysis of the testimony and the exhibits in evidence. It is appropriate to enquire at this point, however, that if the foregoing classes of shares were not,—and could not have been,—delivered by Burkinshaw to Green in the manner claimed by Fein, the burden fell upon defendants to establish how they, as fiduciaries, could claim that they were rightfully entitled to the ownership of these shares.

The District Court has held that the 100,000 Desilets shares were converted by defendants. Trans claims that the defendants also converted

(a)	the "Trenton original issue shares"	150,000
(b)	the difference between 950,000 shares and the 650,000 delivered to Sackett, as set forth above at p. 10	300,000
	Total amount converted	450,000

ARGUMENT

The Applicable Law—Generally

The relationship between Trenton and Fein as an officer, director and controlling stockholder, the inter-twining of financial interest and social relationship between Fein and Green, the control exercised over Trans by Trenton and Fein, the absence of independent directors and the exclusion of the stockholders of Trans for a period of six years from any information concerning the affairs of Trans,—all these circumstances created a fertile soil for self-dealing by fiduciaries.

Fein was the one who handled the transaction for the acquisition of the Sedalia and Oyen gas fields during April of 1960 (Tr. 534-40); he was the principal on behalf of

Trans in connection with the Moab and Cane Creek transactions. He sought to quiet the alleged fears of Green and the other Trenton investors. As Abraham M. Buchman, Esq., the long-time counsel for Trans, testified, Fein was "the boss." (Tr. 1490-2)

Shortly, after the organization of Trenton in 1960 by Green, Fein's own children became stockholders of Trenton. The Fein children owned 47 shares, Fein's brother, A. Edwin Fein, owned 1 share and Fein's sister, Rosa E. Hirsch, also owned 1 share, thus giving Fein 49% of the stock of Trenton while Green (and after 1964, Green's estate) owned 26 shares and Dr. Weiss owned 25 shares (Fein dep., p. 247). Fein and Green had been involved in various business relations since on or about 1948 from which time forward they had become social friends. Green and his law partner, Leon M. Robinson, were elected to the Trans Board of Directors on May 27, 1960.

Between (a) the 83,900 Trans shares which Fein had acquired prior to 1960 (pl. Ex. 130), (b) the 500,000 shares of Trans stock which Trenton acquired as the result of its financing of the acquisition by Trenton of the Sedalia and Oyen gas fields in April 1960 (see p. 7, above) and (c) the divestiture of Anglo-Pacific's shares (see p. 10 above), Fein and Trenton comprised the largest single stockholding group and were able to exercise working control of the affairs of Trans until August 12, 1966 when they surrendered control to Sackett.

It is in the foregoing context that the fiduciary duties of the defendants are to be measured and then adjudicated by the application thereto of Delaware law, *Getty Oil Co.* v. *Skelly Oil Co.*, 267 A.2d 883 (Del., 1970).

1. The relationship of both Fein and Trenton to Trans was as fiduciaries to a *cestui-que* trust and their acts or failure to act may be measured only by the most rigid standards of fairness and good faith. In the landmark case

of *Guth* v. *Loft, Inc.*, 23 Del. Ch. 255, 5 A.2d 503 (1939), the Supreme Court of Delaware held:

> "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."
>
> ". . . [W]hen the persons, be they stockholders or directors, who control the making of a transaction and the fixing of its terms, are on both sides, then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness, tested by all relevant standards, is then the criterion."

This criterion has been followed unswervingly by subsequent courts. *Levien* v. *Sinclair Oil Corp.*, 261 A.2d 911, aff'd, in part, rev'd in part 280 A.2d 717, on remand 300 A.2d 28; *Johnston* v. *Greene*, 121 A.2d 919, 35 Del. Ch. 479; *Penn Mart Realty Company* v. *Becker*, 298 A.2d 349 (Del. Ch.); *Perlman* v. *Feldmann*, 219 F2d 173 (2nd Cir., 1955); *Brown* v. *Bullock*, 194 Fed. Supp. 207 (S.D.N.Y. 1961), aff'd. 294 F2d 415 (1961); *Pepper* v. *Litton*, 308 U.S. 295, 60 S. Ct. 295, 60 S. Ct. 238, 84 L. Ed. 281.

2. As an officer and director of Trans, it was incumbent upon Fein that he subordinate his personal interests to those of the Corporation wherever and whenever the two interests conflicted. *Bayer* v. *Beran*, 49 N.Y.S.2d 2, 5 (Sup. Ct. 1944). In this context, the classic statement of Judge Cardozo in *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 467, 468 (1928), bears repetition.

> "Many forms of conduct permissible in a workday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions (*Wendt* v. *Fischer*, 243 N.Y. 439, 444). Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."
>
> * * *
>
> "If conflicting inferences are possible as to abuse or opportunity, the trier of the facts must make the choice between them. There can be no revision in this court unless the choice is clearly wrong. It is no answer for the fiduciary to say 'that he was not bound to risk his money as he did, or to go into the enterprise at all' (*Beatty* v. *Guggenheim Exploration Co.*, 255 N.Y. 380, 385). 'He might have kept out of it altogether, but if he went in, he could not withhold from his employer the benefit of the bargain' (*Beatty* v. *Guggenheim Exploration Co., supra*). A constructive trust is then the remedial device through which preference of self is made subordinate to loyalty to others (*Beatty* v. *Guggenheim Exploration Co., supra*)."
>
> * * *

> "Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a coadventurer. He was a managing coadventurer (*Clegg* v. *Edmondson,* 8 D. M. & G. 787, 807). For him and for those like him, the rule of undivided loyalty is relentless and supreme (*Wendt* v. *Fischer, supra; Munson* v. *Seracuse, etc., R. R. Co.,* 103 N.Y. 58, 74)."

3. The standards of conduct which measure the obligation of a controlling officer and director are applied with equal force to a dominant stockholder, such as Trenton was during the period of the questionable transactions. *Levien* v. *Sinclair Oil Co., supra; Perlman* v. *Feldmann, supra; Zahn* v. *Transamerica,* 162 F2d 36.

4. Transactions between a fiduciary and himself or between two corporations with dual directorships controlled by the same fiduciaries will be scrutinized with the greatest care by the courts because the dual position of such fiduciaries makes "the unprejudiced exercise of judgment by them more difficult." *Potter* v. *Sanitary Co. of America,* 194 A. 87, 22 Del. Ch. 110; *Johnston* v. *Greene, supra; Everett* v. *Phillips,* 228 N.Y. 227 (1942). As was said by the New York Court of Appeals, in *Chelrob, Inc.* v. *Barrett,* 293 N.Y. 442, 461 (1944), such scrutiny is necessary by the courts "to the end that in the absence of arm's length bargaining the scales may not, even through mistake or inadvertence, be unfairly tipped to one side or the other."

5. To the self-dealing transactions of corporate fiduciaries, most courts (including those in both Delaware and New York) apply the test of fairness. Such a director is required to disclose to the disinterested directors all the relevant and material information he posseses or can obtain on the subject of the transaction. This basic rule goes back more than one hundred years here in the State of New York. *Cumberland Coal & Iron Co.* v. *Sherman,* 30 Barb. 553, 574 (Sup. Ct., 1859). Delaware has long recognized the validity of this rule, *Hodgman* v. *Atlantic Refining Co.,* 274 F.104, 300 F.590, 2 F.2d 893 (D.C., Del., 1921-4). This principle

was ultimately codified by Delaware in 1967 in its General Corporation Law § 144. Other states have even made such disclosure mandatory in their statutes. *E.G.*, West's Ann. Cal. Corp. Code § 820; Mich. Comp. Laws § 450-13; N.C. Gen. Stat. § 55-30; R. I. Gen. Laws 1956; cf. Vt. Rev. Stat. 5800; and W. Va. Code Ann. § 31-6-69. In the case at bar, Fein admitted that he had not even called meetings of the Board of Directors for the purpose of having the Board consider his transactions with Trenton. This is evident from the absence of any reference to these transactions in the minutes. Moreover, as will be specifically identified hereafter, Fein has so conceded. Aside from the obligation to disclose, the transaction itself must be one wherein the *quid pro quo* received by the Corporation, in money or property, must fairly equate in value what it transfers to the self-dealing fiduciary. It has been frequently said that there is a substantial difference between corporate fiduciaries making money *with* their stockholders and making it *out* of them. *General Rubber Co.* v. *Benedict,* 215 N.Y. 18 (1915).

As will be more specifically set forth by way of application to the particular blocks of stock, unfairness is to be found in the private, secretive sale made by Fein to Green of the 500,000 collateral security shares for a price of 2¢ per share when the same stock was being sold over-the-counter for a price in excess of 20¢ per share. Moreover, this block of shares should have commanded a premium because it represented control. (A97-98; Tr. 1007-17; Pl. Ex. 110; Tr. 1149) Likewise, unfairness is to be found in the wholesale attempted transfer of shares and other property by Fein to Green through the letter of August 13, 1960 (def. Ex. L) particularly where the financial interests of both Fein and Green were lodged in Trenton rather than in Trans. itself. *Cahill* v. *Burbage*, 121 A. 646, 649, 14 Del. Ch. 55; *Upson* v. *Otis*, 155 F.2d 606, 610 (2nd Cir., 1946); *Dolese Bros. Co.* v. *Brown*, 39 Del. Ch. 1, 157 A.2d 784) (Sup. 1960); *Kelly* v. *74 & 76 West Tremont Ave. Corp.*, 4 Misc. 2d 533, 151 N.Y.S.2d 900 (Sup. 1956); *North American Iron & Steel Co.* v. *Lefkowitz*, 17 Misc. 2d 284, 184 N.Y.S.2d 707 (Sup. 1959).

6. Once self-dealing is established, the burden of proving fairness and good faith is upon the directors. *Bastian* v. *Bourns, Inc.*, 216 A.2d 680; aff'd. 278 A.2d 467 (Del. Ch., 1967); *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 41 S. Ct. 209 65 L. Ed. 425 (1921); *Sage* v. *Culver*, 147 N.Y. 241 (1895); *Ripley* v. *International Railways*, 8 A.D.2d 310, 188 N.Y.S.2d 62 (1959), aff'd. 8 N.Y. 430 (1960); Niles, "A Contemporary View of Liability for Breach of Trust," 29 *Record of the Association of the Bar* 503-609 (Oct., 1974).

POINT I

The judgment by the District Court that defendants had converted the Desilets shares should be affirmed.

Although the minutes authorized the issuance to Arthur A. Desilets of 150,000 shares, there is nothing in the record to establish that any consideration was ever received by Trans for the issuance of such stock. Mr. Desilets testified at the trial that he knew nothing about any such transaction and knew of no reason why any Trans stock should have been authorized for issuance to him or to his company, Marmot Holdings Corp. (Tr. 476-8, 501-2). There had been an earlier transaction between Marmot Holdings Corp. and Trans which involved the issuance of 1,200,000 shares but that transaction was never consummated, and the stock was never issued. It is Fein's claim that the authorization for the 100,000 shares, several months after the aborted 1,200,000 share transaction, was intended to settle a claim made by Marmot. Desilets knew of no such claim. There is no evidence in the minutes or in any record of any such claim. The only documentation is a *draft* of an Agreement between Trans and Marmot relating to the issuance of 100,000 shares to Desilets (def. Ex. NNN) but that draft was never signed by Marmot or Desilets. The only signatory was Burkinshaw in the capacity of President of Trans. He is the same person against whom Fein inveighed throughout the trial as a crook. If that characterization is correct, and the plaintiffs have never challenged it—then is Trans to be again the victim of the fraud of its officer, Burkinshaw, even where the fraud was never consummated? The Desilets certificates were transmitted by the transfer

agent on April 25, 1960 to Abraham M. Buchman, Esq., then counsel for Trans (Tr. 1480-8, 1490) and he notified Fein of their receipt on April 26, 1960 (Pl. Ex. 13). Buchman testified that he delivered those certificates to Fein (Tr., 1474).

In view of the fact that the transaction with Desilets was never actually effectuated, these certificates should likewise have been returned to the transfer agent. This is another instance of neglect, irresponsibility, or inadvertence on the part of both Fein and Green. Fein, himself, testified during his deposition, that he did not recall whether any shares were ever authorized for issuance to Desilets nor did he recall ever having received any shares of stock in the name of Desilets. He expressed the belief that he had come into physical possession or custody of the shares sometime after the death of Green. (Fein dep., pp. 28-32; 100-17)

He could not recall having seen any stock certificates in the name of Desilets at a time when he claims a file folder containing the number of papers was turned over to him, after Green's death, by someone from Green's office. He could not recall who it was who had transmitted or delivered the file folder nor did he have any record or memorandum of its contents. He had not inspected the folder or its contents when he received it; he simply deposited the folder in Trenton's safe deposit vault at the 43rd Street and Fifth Avenue branch of the Manufacturers Hanover Trust Company. This vault then contained other Trenton papers as well as other stock certificates of Trans. He could not recall whether the stock certificates bearing the name of Desilets had any endorsement or stock powers affixed to them. He simply assumed that whatever stock was there was worthless. He never inquired of anyone as to how it was that the Desilets certificates had been with Green because he was not aware that there were any Desilets certificates. The first time he learned of their existence was *after* the date of his Agreement with Sackett on June 22, 1966. (Tr. 832) He simply "assumed that Trenton Products was the owner." (Fein dep., 100-106)

During his deposition, the following question was put to Mr. Fein and he made the following answer:

> Q. Did you, at any time, Mr. Fein, become the owner of any of the so-called Arthur A. Desilets' stock? A. I don't recall that as having been among the shares given to me by Mr. Green." (Fein dep., 195-6)

On the basis of the foregoing, the Desilets shares remained at all time the property of Trans. They never became treasury shares within the meaning of any applicable statutory or case law. They should have been returned for cancellation. There is no appropriate evidence whatsoever that these shares ever became the property of Trenton or Fein and, certainly, these defendants have not met the burden of establishing how or why they became or could have become at any time the owners of these shares or why they should be the beneficiaries of Burkinshaw's fraud or their own failure to see to the cancellation of these shares.

The Desilets shares subsequently became, after August 12, 1966, the source from which Fein attempted to issue to Messrs. Fieland and Weiss new certificates for 100,000 shares. Judge Conner has found that all the Desilets shares were converted by the defendants.

POINT II

The measure of damages fixed by the District Court was based upon substantial evidence and was clearly appropriate.

After Trenton and Fein surrendered control of Trans on August 12, 1966, they retained possession of the 100,000 Desilets shares without knowledge thereof by Sackett and the other new Trans officers and directors. While still in possession of those shares and the Trans stock transfer records (Pl. Ex. 120; Tr. 1354-7), Fein issued and delivered to Fieland 70,000 shares and to Weiss the balance of 30,000 shares. These shares were unregistered but neither were they restricted.

If validly in the hands of a third-party, these shares were freely saleable like the other shares of Trans which otherwise had never been registered with the S.E.C. nor were they required to be registered for transfer to others.

Delivery of the shares to Fieland and Weiss took place after the August 12, 1966 closing date although the certificates themselves were pre-dated to August 5. (Fein dep., 119-120; 125). Trans' new management did not learn of the possible conversion until on or about October 5, 1966 (Pl. Exs. 128, 95; Tr. 189-195, 204, 1354-56). It sought information from the defendants and not until October 31, 1966 was there an out-and-out refusal by the defendants to restore possession of the shares to Trans. The latter date, —rather than October 5, 1966,—may well be regarded as the date that Sackett learned of the *actual* conversion of the subject shares. (Tr. 189, 190, 195, 204).

The two most persuasive facts evidencing the reasonable value of the shares are (a) the value placed on them by Fieland and Fein themselves, and (b) the actual prices at which Fieland sold 40,600 shares of his 70,000 shares between August 12 and October 6, 1966.

Trenton and Fein themselves placed a value on similar Trans stock of *more* than $.50 per share. Commencing with the service of their first answer and counterclaims herein (Tr. 33-4, 40) and continuing through the assertion of their claims in the Pre-Trial Order (Tr. 63-7), the defendants attributed a value of $210,000 to 300,000 shares. That amounted to $.70 per share. (See also Pl. Ex. 117).

The defendants have singularly refused to come to grips with the express language contained in the document which Fein delivered to Fieland wherein the 70,000 shares were expressly identified as being "in lieu of the sum of $35,000 . . . ." (Fieland Ex. D). Fein has claimed that he had promised Fieland reimbursement of the difference between the $35,000 and the amount Fieland might be able to obtain upon the sale of the 70,000 shares. It is strange indeed that at no time did Fieland ever even remotely advert to any such agreement nor did Fein ever offer proof thereof by any writing, note or memorandum.

Paragraph 6 of Fieland's verified complaint in a separate New York Supreme Court action (Pl. Ex. 106) states:

> "In or about the months of August to October inclusive, 1966, plaintiff, through Herzfeld & Stern, stockbrokers, sold 40,600 of said shares for the net price of $15,982.50, and in or about the months of August to October, 1966, delivered to Herzfeld & Stern stock certificates numbered B-6392 to B-6401 inclusive for delivery to the purchasers (the excess to be retained for plaintiff's account)."

Paragraph 12 thereof states:

> "Defendant, Continental, is liable to plaintiff for plaintiff's damages as follows: (a) in the amount of $15,982.50, which is the value at the time and place of sale of 40,600 shares sold for plaintiff by Herzfeld & Stern; (b) . . . .; (c) . . . .; (d) the amount of $30,000, the reasonable value of the balance of shares held by plaintiff for sale within a reasonable time after defendant Continental refused to transfer the shares sold by plaintiff."

Upon the trial herein, Fieland testified he sold 40,000 shares, some of them in August 1966 (Tr. 944). The sale was made through Herzfeld & Stern, the Wall Street brokerage firm with which Fein's sister was associated (Tr. 944-45). Thus *before* new management learned of the conversion, the actual market price for Fieland's 40,600 shares was $.393 per share. His complaint was verified on March 30, 1967 and he alleged in paragraph 12 thereof that the fair value for his remaining 34,400 shares "within a reasonable time" after the stop notice (October 5, 1966—when Trans' new management had just learned of the possible conversion) was $30,000. This amounts to $.87 + per share!

This claim of $.87 per share by Fieland is not too far from the value of $.70 per share placed by Trenton and Fein on the 300,000 shares for which they counterclaimed.

It is submitted that if (a) Fieland actually sold 40,600 shares at $.393 per share, (b) Fieland placed a value of $.87 per share on 34,400 shares within a reasonable time

after October 5, 1966, and (c) Fieland and Fein valued "their" 300,000 shares,—which Trans refused them the right to transfer—at $.70 per share, then the claim of plaintiffs for $.54 per share was modest indeed and Judge Conner's valuation of $.44 per share "rock bottom"!

That at least $.44 per share was a fair and reasonable value is corroborated by the bid and asked prices, as reported by the National Quotation Bureau (Pl. Ex. 131). The average of the bid and asked prices for a period of six months from the time when Trans' new management learned of the conversion, as derived from that exhibit, was $.54 per share.

The stock that came into the hands of Fieland and Fein, as the re-issued certificates of the so-called Desilets shares, had no restriction on its face nor was it so-called "lettered" or "legended" stock. The defendants have sought to throw sand in the eyes of the trial court by urging that, whatever the value of the stock might be, a discount factor should be applied because it was not registered stock. The fact is that at no time had Trans ever had any registered stock. The stock had entered the market many years earlier under exemptions to the Securities Acts. The Trans stock was sold before 1966 freely, without registration, and it continued to be sold thereafter without registration. The undisputed fact is that both Fieland and Fein have sold their shares without registration. Thus, there is no warrant for applying any discount factor whatsoever.

The testimony of Robert Martin, the so-called investment advisor and stock expert, is unworthy of belief. He was clearly neither impartial nor independent. At the trial, he admitted that he was a "friend" of Fein; that he had been then in receipt of commissions from Fein and was expecting to receive commissions from him on other business in the future. (12/8/75 Tr. 30-1) His conclusion that the Desilets shares had little or no value flies in the face of undisputed facts. Mr. Martin stated that it was necessary to consider actual transactions in the Trans common stock in 1966. The fact is he ignored completely the sales made by Fieland of 40,60 shares for $15,982.50, or $.393 per share even though he was aware of these sales. Thus, on cross-

examination, the following exchange took place which only served to establish that the market value of Fieland's shares was then well in excess of $.50 per share!

> Q. Did you ascertain at what prices Mr. Fieland sold his stock? A. Yes, I did.
>
> Q. And do you have that? A. Yes, I do.
>
> Q. And what prices did he sell his stock at? A. I understand that he was able to realize the amount of the indebtedness due to him and I think it is also signicant in evaluating that transaction—
>
> Q. Excuse me, I asked you a question. A. I'm trying to answer your question.
>
> Q. Did you ascertain the price at which he sold his stock? A. The approximate price for the proceeds, yes.
>
> Q. How many shares of stock did he sell? A. I am not sure of that. I was led to believe that he liquidated enough shares to pay the indebtedness [$35,000] due to him. (12/8/75 Tr. 32-3)*

If the stock were worthless, why did Fieland, Fein and Trenton resist so vigorously the claims of Trans from their very inception in 1966? Why have Fein and Trenton persisted in pressing their counterclaims even to this present appeal?

While it is quite true that, as of August 12, 1966, the financial condition of Trans was bleak, the takeover by Sackett and his group was a harbinger of a hopeful change for the future. New and vigorous management was coming in and a substantial investment was being made by that new management in the company. Mr. Martin never interviewed that management (12/8/75 Tr. 32). From the moment Sackett and his associates took over control, they transformed Trans from a mere shell into a genuine, operating and successful company. This is manifest from the summary of its reports (Pl. Ex. 129). The annual reports themselves were admitted into evidence as Defendants' Exhibit UUUU.

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* Denotes transcript of 12/8/75 trial on issue of damages.

The general rule for the determination of the damages sustained by Trans would require the computation of the value of the Desilets shares to Trans within a reasonable time after its new management acquired knowledge of the conversion. *Hartford Accident & Indemnity Company* v. *Walston & Co., Inc.*, 22 N.Y.2d 672, 291 N.Y.S.2d 366; *German* v. *Snedeker,* 257 App. Div. 596, 13 N.Y.S.2d 237, *reargd. den.* 258 App. Div. 708, 14 N.Y.S. 2d 1012, aff'd. 281 N.Y. 832; *Gelb* v. *Zimet Brothers, Inc.,* 34 Misc. 2d 401, 228 N.Y.S.2d 111, aff'd. 18 A.D.2d 967, 237 N.Y.S.2d 989.

In Re Salmon Weed & Co., 53 F.2d 335 (CCA, 2d, 1931), traces the development of the foregoing principle and states that

> ". . . the proper rule, as stated by the courts in Wright v. Bank of the Metropols, 110 N.Y. 237, 249, 18 N.E. 79, 1 L.R.A. 289, 6 Am. St. Rep. 356, is that 'the plaintiff is entitled to the highest price reached within a reasonable time after the plaintiff has learned of the conversion of the stock *within which he could go into the market and repurchase it.*' " (italicizing added) (p. 341)

In the case at bar,—as appears above,—it is undisputed that new management first learned of the possible conversion of the Desilets stock on or about October 5, 1966 and was not advised until October 31, 1966 by the defendants that they intended to retain possession of that stock. Under the circumstances which then confronted Trans, what was the reasonable time "within which [it] could go into the market and repurchase" 100,000 shares? That principle is applicable here at least to the extent that sixty days would be a *minimum* reasonable period of time after knowledge of the conversion, *Mayer* v. *Monzo,* 221 N.Y. 442, 446-7, citing cases.

Even this limitation of sixty days must not necessarily be applied to the case at bar because the stated rule rests upon the fundamental theory that the plaintiff should only be justly indemnified and he must be vigilant to hold down or reduce his loss. Such a party cannot permit his damage to grow and charge it to the wrongdoer by reason of his own inattention, want of care or inexcusable negli-

gence. *Jones* v. *National Chautauqua County Bank,* 272 App. Div. 521, 74 N.Y.S.2d 498; *Wright* v. *Bank of Metropolis,* 110 N.Y. 237, 245. Thus a wider latitude than sixty days should be permissible where a fiduciary has wronged his *cestui que trust.* By analogy, the Court is respectfully referred to *Hayward* v. *Edwards,* 4 N.Y.S.2d 699, 167 Misc. 694.

It is obvious that Trans was unlike the usual investor, trader or speculator who buys and sells corporate securities. Trans was not in the business of trading in its own stock nor did it have the means with which to go into the market to purchase 100,000 shares in place of the shares which had been converted. Under the circumstances, the term "reasonable time" should receive a construction which would do justice to Trans in the light of the situation which then was prevailing.

Commencing August 12, 1966, a change in management from Fein and Trenton occurred and Sackett and his associates took control. The settlement of the litigation and the papers filed with this Court in connection therewith detailed the straitened financial circumstances of the Corporation and the fact that new management was investing $200,000 to turn the Corporation around and make it a successful and viable entity (Defts. Ex. "C", pp. 15-17 thereof annexed hereto). Especially under these circumstances, and considering the added factor of the converters being fiduciaries, who should not be permitted to profit from their own wrong, *Cahall* v. *Lofland,* 12 Del. Ch. 299, 114 A. 224; *Upson* v. *Otis,* 155 F.2d 606, the term "reasonable time" ought to be given the widest possible latitude. The District Court below fixed that time at less than 6 weeks after Trans' new management discovered the conversion. Clearly there was no error; if anything Judge Conner did not give Trans "the widest possible latitude."

Pierpont v. *Hoyt,* 260 N.Y. 26, 30 cites with approval *Pollock on Torts* [13th Ed.], p. 372 for the doctrine that the essence of conversion is "that the use and possession were dealt with in a manner adverse to the plaintiff and inconsistent with his right of dominion." Having been deprived of its property, Trans pursued the remedies that

were then open to it, namely, the stoppage of further transfer of the stock by making Fieland as well as the other defendants subject to the "stop order" and a "temporary and permanent injunction enjoining and restraining Trenton, Fein, Weiss and Fieland from transferring any and all of the shares of Trans described in said account;" (Complaint, A 24).

POINT III

The only shares rightfully acquired by Trenton were (1) the 141,000 treasury shares (the so-called "Brown" shares) as authorized by the amending resolutions of May 17, 1960 and (2) the Trenton-Anglo purchase shares (A19620, A19625) for 150,000 shares. All other shares which came into the possession, custody or control of Trans and/or Fein are shares which remained solely and exclusively the property of Trans. The Court below erred in failing to find that Trenton and Fein had converted these shares.

A. The Collateral Security Shares

The record evidence is undisputed and Judge Conner found that Anglo-Pacific delivered to Trans its note for $39,043.50 (A 97). Fein testified that the note was pre-dated to December 31, 1959 so as to make it an asset of Trans for the fiscal year ended December 31, 1959 (Tr. 556-7). The initial security was 200,000 shares and then this was increased, at Fein's insistence, to 500,000 shares (Tr. 557-8).

Upon default, Fein caused the shares to be sold at a private unadvertised sale to Trenton for 4¢ per share. The sale was apparently not consummated in view of protests made by Anglo-Pacific. Another sale was effected on March 22, 1961, approximately some six months later at another private unadvertised sale where only Fein and Green were present. The sale was not discussed or mentioned to anyone else (Fein dep., pp. 250-1, 264-5, 316; Tr. 1007-8).

Complete silence shrouded the transaction. Other directors were not advised nor was authority ever obtained from the Board to sell the shares (Tr. 1007-8). The sale was made at a time when Fein and Green were in control

of both Trans and Trenton. Fein and Green were the controlling directors of Trans and, of course, Trenton was nothing but their *alter ego*. Moreover, the sale took place at a time when the financial condition and prospects of Trans looked more hopeful than they had been when the earlier sale for 4¢ per share was made (Tr. 1014). The proof is clear that at the time of the sale the over-the-counter market showed bid and asked prices in excess of 20¢ per share. In addition, these 500,000 shares were vital to the continued control of Trans and Fein stated this was one of the reasons why the sale was made so that the control of Trans would be continued (Tr. 558).

While it does appear that, at the time of the sale, Trans was without a ready source of income and required monies to pay for expenses then being incurred, there was no compelling reason for Fein to sell 500,000 shares to Green and himself to raise only $10,000. For one thing, in lieu of any sale of these shares at all, an effort could have been made to obtain outside financing. No such effort was considered or made (Tr. 1012-17). If in the exercise of sound business judgment, the determination were made to sell the collateral, then it should have proceeded at a public sale where, indubitably, the amount realized for this block of control stock would have yielded to Trans not only the face amount of the note, to wit, $39,043.50, but the proceeds would have been very considerably more. In view of the claims which Trans was then asserting against Anglo-Pacific, both in Colorado and in New York, Trans could have retained the surplus money proceeds and resisted their transmittal to Anglo-Pacific. Further, there was a contractual basis for the retention of these proceeds and even the original 500,000 shares. This authority was to be found in the August 12, 1960 Agreement (Pl. Ex. 118). This consequence was expressly noted by the Court during the trial (Tr. 1268-9).

Thus, the sale of the 500,000 shares for the "ridiculous" price of 2¢ per share (so characterized by the Court itself) was not a fair sale and those shares should have remained the property of Trans, subject to a credit in favor of Trenton for the $10,000 alleged to have been paid by Trenton.

No proof was ever offered that, in fact, such $10,000 was even paid by Trenton to Trans.

B. The August 12, 1960 Agreement Shares (A19621, A19624 and A20327)

In or about August 17, 1960, Anglo-Pacific's attorneys transmitted 350,000 shares of Trans stock to Buchman & Buchman, Esqs., of which 300,000 shares were intended for delivery to Trans pursuant to an Agreement dated Aug. 12, 1960 (Pl. Ex. 17). 250,000 shares were represented by certificates A20327 for 150,000 shares (registered in the name of Elsie Chamberlain) and A19624 for 100,000 shares. Certificate A19621 was to be divided into 2 certificates, each for 50,000 shares, and 1 such certificate was to be returned by Buchman & Buchman, Esqs. to the transmitting attorneys while the other certificate for 50,000 shares was to be transmitted to Trans in accordance with the Agreement dated August 12, 1960. By reason of the controversy then existing between Trans and Anglo-Pacific, Buchman & Buchman retained possession of certificate A19621 and it was not released by them until after August 12, 1966 when Sackett came into control of Trans. Thus, A19621 is not presently involved in the current litigation. The other 250,000 shares were turned over by Buchman & Buchman to Fein and, thus, he acquired possession of certificates A20327 and A19624 for 250,000 shares.

Clearly, these shares could not have been part of any "batch" which Fein testified had been physically delivered by Burkinshaw to Green. His testimony as well as plaintiffs' exhibits 17, 18, 19, 20 trace the route certificates A20327 and A19624 took. They were transmitted by Anglo-Pacific's attorneys to Buchman & Buchman and then delivered by them to Fein. Such delivery was pursuant to the terms of the August 12, 1960 Agreement (Pl. Exs. 17, 118). Under the terms of that Agreement, the stock became the property of Trans.

The contention is made that those shares subsequently became the property of Trenton by reason of the terms of a letter, dated August 13, 1960, from Fein to Green (def. Ex. L).

Fein's right to transfer these 250,000 shares to Trenton must be considered in the light of the standards of fairness and fiduciary duty as enunciated so many times by the courts of this State, the State of Delaware and the Supreme Court of the United States. Both Trans and Trenton were the victims of a fraud perpetrated by Burkinshaw but Fein's primary concern was to protect the interest of Trenton where his real financial interest lay. Fein made no inquiry of counsel for Trans as to whether there was any reasonable defense which Trans could make as against Trenton's claim. The note itself was not due to Trenton for three years. Instead of following a prudent, responsible and loyal course of conduct which would best serve the interest of Trans, Fein made haste to sign the letter dated August 13, 1960 in favor of Trenton (def. Ex. L).

Without conceding the validity or efficacy of paragraph 4 of defendants' Exhibit L and assuming *arguendo* that the transfer by Trans to Trenton of these 250,000 "August 12, 1960 shares" was proper and fair, then these 250,000 shares together with (a) the 300,000 shares previously rightfully acquired by Trenton and (b) the 100,000 shares of certificate A19621 (which Buchman was holding in escrow as set forth in the foregoing exhibits) would aggregate the 650,000 shares which Trenton had agreed to deliver to Sackett under the June 22, 1966 Agreement.

Thus, in either case, certificates A19624 and A20327 should have remained the property of Trans or should have been transferred by Trenton to Sackett pursuant to the aforesaid Agreement of June 22, 1966. In neither event, should those shares have been available to Trenton or to Fein after the consummation of the Sackett transaction on August 12, 1966.

C. The Trenton Original Issue Shares (Certificates A19527/56)

Reference has already been made above to the original authorization by the Board of Directors for the issuance to Trenton of 150,000 shares as part of the consideration for the loan made by Trenton to Trans to finance the acquisition of the Sedalia and Oyen gas leases. Subsequently, as

the result of the request of Green for saleable stock instead of restricted stock, the Trans Board on May 27, 1960 amended its prior authorizing resolution and, instead, authorized the delivery to Trenton of 141,000 treasury shares (the so-called "Brown" shares) and 9,000 new issue Trans shares. The clear import of this action by the Trans Board was that 150,000 original issue shares should be cancelled. As appears from plaintiffs' Exhibit 13 the 150,000 original issue shares (certificates A19527/56) had already been transmitted by Texas Bank & Transfer Company to Abraham M. Buchman, Esq. and he had delivered them to Fein. It was Fein's intention (Tr. 655-63, 677, 633-4) and even, more so, his duty to see to the cancellation and return of those stock certificates to the Transfer Agent. That was equally the duty of Green who was then not only a controlling director along with Fein but also the Secretary and Treasurer of the Company. Through neglect, indifference, irresponsibility or oversight, the certificates remained in the possession of Green and did not come to light again, as testified by Fein upon his trial, until sometime in 1969 or 1970 when the certificates, exclusive of only A19527 and A19528, were delivered by Green's surviving partner, Leon Robinson, (also a former director of Trans) to Fein (Tr. 622-3).

During the course of the trial, the Court expressed the opinion that these shares had assumed the character of "treasury shares." (Tr. 678-695, 762-765) It is respectfully submitted that the conclusion drawn by the Court upon the trial is erroneous in fact and in law.

There was no consideration to Trans for the issuance to Trenton of more than 150,000 shares. Those shares had to be either the original issue shares (A19527/56) or the 141,000 "Brown" treasury shares and an additional 9,000 original issue shares. The consideration in favor of Trenton could not be both; it was one or the other. When Green opted for the "Brown" treasury shares and the additional 9,000 shares, there was no consideration to support the issuance of the original issue shares identified as certificates A19527/56. Stock issued without consideration is uniformly held to be void. *Blair* v. *F. H. Smith Co., et al.,*

18 Del. Ch. 150, 156 A. 207 (1931); *Diamond State Brewery, Inc.* v. *de la Rigaudiere*, 25 Del. Ch. 257, 17 A.2d 313 (1941); *In re Seminole Oil & Gas Corp.*, 150 A.2d 20, 20, 30 Del. Ch. 246, app. dism., 159 A.2d 276, 39 Del. Ch. 73 (1959).

Article IX, Sec. 3 of the Delaware Constitution provides:

> "No corporation shall issue stock, except for money paid, labor done or personal property, or real estate or leases thereof actually acquired by such corporation."

To the same effect is § 152 of the General Corporation Law (formerly § 14) and see also *In re Seminole Oil and Gas Corp., supra;* 11 Fletcher Corp., 1971 Rev. Ed., p. 262, § 5161.

If the issuance of stock is void, it must be cancelled. *Diamond State Brewery, Inc.* v. *de la Rigaudiere, supra.* Fein repeatedly testified, during his deposition and upon the trial, that it was the Board's intention to cancel those shares and he assumed they had been (Tr. 633-4; 657-8; 663-4; 677; 748).

Under the circumstances, it would be a waste of the corporate assets to permit the issued shares, A19527/56, to attain the status of treasury shares. This would permit the negligent and irresponsible acts of both Fein and Green in failing to see to the cancellation of their shares to result in producing a benefit for them. It is axiomatic that a fiduciary cannot profit from his own wrong. *Cahall* v. *Lofland*, 12 Del. Ch. 299, 114 A. 224 (1921); *Upson* v. *Otis, supra.*

Finally, the term "treasury shares" has a well-defined meaning as a matter of law. Treasury shares are those which have been issued to stockholders as fully paid and subsequently re-acquired by the Corporation to be used in furtherance of its corporate purposes; undelivered stock or stock issued without consideration never becomes "treasury" stock. *In re Public Service Holding Corp.*, 26 Del. Ch. 436, 24 A.2d 584 (1942). Moreover, § 153 of the Delaware General Corporation Law would have required that the value of any treasury shares delivered to Trenton or to Fein be fixed by action of the Board of Directors. Concededly, no such action was ever taken.

POINT IV

The purported transfer of shares by Fein through the execution of Trans stock certificates for his beneficial interest or for the beneficial interest of Trenton, after the death of Green, was void as a fraud upon Trans and a conversion of its assets.

By resolution of the Board of Directors, Fein and Theresa Zappley, his secretary, were appointed the new transfer agents for Trans in place and in stead of Texas Bank & Transfer Company. The corporate secretary and treasurer, Green, was already deceased. Nevertheless, as transfer agent, Fein thereafter made transfers of corporate shares by issuing new certificates in place of those which were surrendered. The plaintiffs do not challenge the transfers so made by Fein except as to those transfers which were made for the beneficial interest of Fein himself or for the beneficial interest of Trenton. Trans challenges the right of Fein to profit from his own wrongdoing where its effect was to defraud Trans and work a conversion of its assets.

Article VI, Section 1 of the By-Laws (Pl. Ex. 40-C) states:

> "SECTION 1. *Certificates of Stock:* Certificates of stock, numbered and with the seal of the corporation affixed, signed by the President or Vice-President, and the Treasurer or an Assistant Treasurer, or S y or an Assistant Secretary, shall be issued to each stockholder certifying the number of shares owned by him in the corporation. When such certificates are signed by a transfer agent or an assistant transfer agent or by a transfer clerk acting on behalf of the corporation and a registrar the signatures of such officers may be facsimiles."

§ 158 of the Delaware Corporation Law, as in effect in 1966, stated that certificates of stock shall be signed only in the following manner:

> "Every holder of stock in a corporation shall be entitled to have a certificate, signed by, or in the name of the corporation by, the president or a vice-president and the treasurer or an assistant treasurer,

> or the secretary or an assistant secretary of such corporation, certifying the number of shares owned by him in such corporation. Where such certificate is signed (1) by a transfer agent or an assistant transfer agent or (2) by a transfer clerk acting on behalf of such corporation and a registrar, the signature of any such president, vice-president, treasurer, assistant treasurer, secretary or assistant secretary may be facsimile. In case any officer or officers who have signed, or whose facsimile signature or signatures have been used on, any such certificate or certificates shall cease to be such officer or officers of such corporation, whether because of death, resignation or otherwise, before such certificate or certificates have been delivered by such corporation, such certificate or certificates may nevertheless be adopted by such corporation and be issued and delivered as though the person or persons who signed such certificate or certificates or whose facsimile signature or signatures have been used thereon had not ceased to be such officer or officers of such corporation."

The clear import of the foregoing is that where facsimile signatures are used, the signature of the transfer agent must be some person other than the officers whose signatures appear on the stock certificates as facsimiles.

Thus, aside from the inherent defects that already attended the misappropriation and conversion of the certificates, the issuance of new stock certificates derived therefrom was a nullity and void and simply a further manifestation of the wrongdoing of Fein. The purported issuance of these new certificates constituted but another step along the path of misappropriation, conversion and breach of fiduciary duty.

It should be pointed out, further, that not only were the aforementioned certificates void as a matter of law but, in addition, they were issued by Fein when he no longer had

authority to do so. His transaction with Sackett was concluded. On August 12, 1966, he stated that he was then engaged in completing the processing of certificates which had been surrendered to him as the transfer agent of the Company and he was, thereupon, authorized to complete such processing (Pl. Ex. 120; Tr. 1354-7). Certainly, no license was given to him to proceed in the conclusion of a conversion of stock belonging either to Trans or to Sackett.

POINT V

The failure and refusal of Trenton and Fein to deliver to Sackett all of the stock validly and lawfully acquired by Trenton was a fraud upon Sackett.

The clear import of the June 12, 1966 Agreement (def. Ex. I) was that Sackett was acquiring all of Trenton's stock interest in Trans. The only disposable stock left to Fein was that stock which he had acquired in the ordinary course of his business by purchases in the open market prior to 1960. Both Sackett and Fein testified that at the time of the various conversations and negotiations which preceded the execution of their June 22, 1960 Agreement, the amount of such personal shares were estimated to be approximately 70,000. It is significant that after Fein consummated his transaction with Sackett on August 12, 1966, he proceeded to sell those personal shares in the open market and such sales were consummated without hindrance by Sackett or by Trans. The Court's attention is respectfully directed to Schedule D of Fein's 1966 Federal Income Tax Return (Pl. Ex. 30) which shows that he was the owner in 1955 of a total of 83,900 shares which he proceeded to sell in four separate installments as follows:

15,000 shares — August 1966
26,600 shares — September 1966
38,800 shares — October 1966
3,500 shares — October 1966

Defendants' trial counsel repeatedly characterized the Sackett-Fein transaction as a "note deal" as if,—by con-

stant reiteration,—such characterization would transform a patently incredible version of the transaction into a reality.

The Agreement between the parties might have been more skillfully drawn. There are ambiguities and, it may be, that counsel who were responsible on both sides for seeing to the drafting left something to be desired. It may be that greater clarity would have been achieved had there been a provision which expressly stated that the 650,000 shares represented all the shares which Trenton and Fein were selling (exclusive of Fein's personal shares).

In the face of the ambiguities inherent in the Agreement, the Court has admitted parol testimony in an effort to ascertain the true intention of the parties. What was that intention?

Could the transaction have been essentially a "note deal", as contended by Fein who out of the goodness of his heart finally threw in 650,000 shares? It is incredible to believe that Sackett was paying Fein $187,500 for the dubious pleasure of trying to collect from Trans, in its then straitened financial circumstances, the $224,000 principal balance of the note. While even the most experienced and knowledgeable businessman,—and Sackett was all of that and more,*—may make mistakes in business judgment, they are not given to doing things as wildly foolish, nay insane, as paying $187,000 for a $224,000 note which was then in default for six years, particularly the note of a corporation such as Trans was at that time.

Obviously, Sackett was not buying a note. He was buying out the whole position which Trenton and Fein had in Trans, not only the debt owed to Trenton but also the en-

* Lawyer; F.B.I. agent in charge of N. Y. Office; U.S. Army Officer on staffs of General MacArthur, General Eisenhower and General Bradley; President and Chairman of Board of Chesapeake Industries; trustee in bankruptcy; management consultant (Tr. 18-20).

tire stock position which Trenton and Fein had, exclusive of Fein's personal shares.

In connection with securing the approval of Hon. Harold L. Tyler of this Court to the settlement of the prior derivative litigation, Sackett and his new associates assured this Court that not only were they investing $187,000 in paying out Trenton but that they were also paying off other obligations of Trans and also investing a further $200,000 in working capital in order to convert Trans into a viable company (def. ex. C; A 181, 192-9). It is absurd to suppose that Sackett and his associates would contemplate such an investment if for one moment they believed or had any reason to believe that, beyond 650,000 shares which were being sold under the terms of the Agreement, there remained in the hands of Trenton and Fein the huge quantity of other shares which have been described above. Such shares would hang over their control as a veritable sword of Damocles. The number of shares originally held by Sackett and his associates, together with the 650,000 shares they acquired from Trenton and Fein, would have been approximately equal to the amount retained by Trenton and Fein, if effect were given to the claims made by the latter as to the shares described in Part II above. Such a prospect could not have been contemplated by the parties.

Sackett's version of the transaction is fully reported by the contemporaneous affidavit of Irwin M. Taylor, verified June 22, 1966, the very date of the Agreement itself and filed with the District Court on June 23, 1966 in support of an order to show cause for the holding of a hearing to seek approval of the Court, upon notice to stockholders, of the settlement of the litigation between Sackett and Fein (def. ex. C; A 181). The Court's attention is respectfully directed especially to pages 8, 12 and 13 of that affidavit

(A 189, 192, 193) wherein the Court was expressly advised that the settlement required Fein and Trenton to assign *all* of their legal, equitable and beneficial interest which they had in the property and assets of Trans and that

> "the resulting effect of the payment by [Sackett] and his associates of the sum of $187,500 in cash to Fein and Trenton is to substitute [Sackett] and his associates for Fein and for Trenton vis-a-vis Trans. . . ."

The said affidavit was part of the motion papers served upon counsel for defendants. Neither oral nor written objections to its contents were ever made.

Finally, it is to be observed that the copy of the certified resolutions delivered by Trenton to Sackett upon the closing, with respect to the approval of the Agreement between them and the authorization for its implementation, stated, among other things,

> "RESOLVED, that Bernard Fein, the President of this Corporation, shall have full power and authority to execute and deliver on behalf of this Corporation all instruments for the purpose of effecting the sale of any securities owned by this Corporation, including without limitation of the foregoing, *all* shares of capital stock of Transcontinental Oil Corporation owned by this Corporation, . . ." (part of def. Ex. J; italicizing added; see A 211)

Likewise, a separate certification was annexed to the two stock certificates delivered by Trenton to Trans upon the closing on August 12, 1966, namely, certificates B5962 for 500,000 shares and B6245 for 100,000 shares (Pl. Ex. 85). The latter certification contained the identical language quoted above and expressly authorized the President of Trenton to deliver *all* shares of Trans stock owned by Trenton. Considering what the intention of the parties was, as asserted here by plaintiffs, only such an authorization could have been aceptable. If the resolution had simply recited that the number of shares was limited to 650,000 shares, then such resolution would not have been acceptable to the plaintiffs upon the closing. The only reasonable con-

clusion, in the light of the foregoing, is that the parties intended that Trenton and Fein should convey *all* of their stock interest to Sackett, except for Fein's personal shares.

POINT VI

Trenton and Fein breached their express warranty with respect to the number of issued and outstanding shares of Trans stock.

As the purchaser of the 650,000 Trans shares owned and delivered by Trenton on August 12, 1966, Sackett was entitled to have the benefits of a corporation which was expressly represented to him to have no more than 3,600,000 shares outstanding. Instead, the total number of such shares turned out to be 3,977,605 (Pl. Ex. 128).

Thus, the value of the purchase of stock made by Sackett was impaired in that the corporate assets were owned by more shareholders than was expressly warranted to him and the value of his shares was *pro tanto* reduced,—to his damage.

POINT VII

The affirmative defenses of *res judicata* and release as to the *first and second counts are without merit.*

In *Ruskay* v. *Jensen,* 342 F. Supp. 264, 268 (SDNY 1972), cited by defendants, Judge Metzner set forth the applicable rules of *res judicata* but expressly recognized that

> "where the second action is upon a different claim or demand, the prior judgment operates as an estoppel only as to those issues actually litigated and determined in the prior suit."

In applying the doctrine of *res judicata* to the aforesaid cited case, Judge Metzner found that the claims for relief in the litigation before him depended on the same operative facts in the second lawsuit as in the first lawsuit and they pertained to the same disputed transactions. This is clearly not the situation in the case at bar involving the first and second counts.

In the instant case, the wrongs upon which Trans sought relief are different from those which were alleged in the

prior action. The test of identity has been held to be determined by whether the same evidence would suffice to sustain both causes of action. *Kelleher* v. *Stone & Webster,* 75 F.2d 331, 333; *Woodbury* v. *Porter,* 158 F.2d 194, 195.

An analysis of the pertinent allegations in the prior action and the allegations and proof in the present action demonstrate that the claims of the defendants are patently erroneous.

Paragraph "22" of the prior complaint alleged that Fein had caused the stock of Trans to be *issued* at nominal, unfair and inadequate consideration to certain unknown *third parties* and that such issuance was a waste of the assets of Trans. Paragraph "23" charged Fein also with having *purchased* issued and outstanding stock of Trans where he should have made the purchase for the benefit of Trans instead of for his own benefit (A 176-7).

Unlike the allegations contained in the foregoing paragraphs of the prior complaint, the new complaint did not charge Fein with having caused Trans stock to be issued at nominal, unfair and inadequate consideration to any third parties nor did the allegations in the current complaint allege that Fein had acquired stock from others that he should have acquired instead for the benefit of Trans. Quite to the contrary, paragraph "13" of the current complaint states that Trenton and Fein, sometime between August 17, 1960 and August 12, 1966 appropriated for themselves some 300,000 shares of Trans stock. This stock is described in paragraph "12" of the complaint as being shares previously issued to Anglo-Pacific and being shares which Anglo-Pacific had agreed to return to Trans (A 12). Incontrovertibly, the trial evidence showed in fact that all the shares were physically returned to Trans. Trenton and Fein laid claim to those shares in reliance upon their Exhibit L (A 95-7).

Thus, unlike the allegations in paragraphs "22" and "23" of the prior complaint, the 300,000 shares originally mentioned in the current complaint are entirely unrelated to any stock which Fein may have issued to third parties for any nominal, unfair and inadequate consideration. The

current complaint expressly states that the 300,000 shares involved were all part of the consideration paid to Anglo-Pacific for the purchase by Trans of the outstanding stock of White River Exploration Company. The complaint makes no claim that the transaction was unfair or otherwise invalid. Moreover, it clearly appears from the complaint alone that the 300,000 shares were shares that were alleged to have been returned to Trans and *converted* by Trenton and Fein. These shares had nothing whatsoever to do with the allegations contained contained in paragraph "23" of the prior complaint.

The record is clear that at no time did Anglo-Pacific ever deliver any shares to Trenton, except for the 150,000 shares which Anglo-Pacific paid to Trenton in April 1960 for the acquisition of a ⅛th working interest in the Sedalia and Oyen gas fields (see p. 9 above). That transaction is not under attack in the current litigation. What is under attack is how 750,000 of the remaining 800,000 Trans shares which Anglo-Pacific received should have ended up with Trenton and Fein when they were actually and indubitably returned only to Trans. (The Court is respectfully reminded that Mr. Buchman retained 50,000 shares in escrow.)

It is respectfully urged that the burden was upon Fein, as a fiduciary, to explain to this Court how and why the certificates ended up with Trenton. *Bastian* v. *Bourns, Inc.*, 216 A.2d 680; *aff'd.* 278 A.2d 467 (Del. Ch., 1967); *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 41 S. Ct. 209 (1921) and other authorities at p. 19 above. The shares for which the plaintiffs make claim are shares evidenced by certificates dated after August 4, 1966. Fein testified he did not prepare the certificates, sign and deliver them until after August 12, 1966 (Fein dep. 119-20, 125, 189-198).

The Settlement Agreement with Fein was made on June 22, 1966 and the Court approved the settlement on July 12, 1966. Obviously, there can be no doctrine of *res judicata* (or of release) applicable to events which occurred after the inception of the first litigation and after the date of approval of the settlement. Moreover, as indicated above,

the transactions in the second complaint are clearly not at all the transactions described in the first complaint.

The Desilets transaction has absolutely no relationship whatsoever to the allegations contained in the first complaint. Paragraphs "16" and "17" of the current complaint clearly state that 100,000 shares of stock were authorized for issuance and were issued in the name of Arthur A. Desilets. These shares were *not* issued by Fein but by Burkinshaw. The proof is irrefutable that Mr. Desilets never knew about the issuance of the stock, never received the stock certificates and never authorized them for transfer to anyone else. Mr. Buchman testified he received them from the Texas Bank & Transfer Company and delivered them to Fein. Apparently, the shares never left Trans. Fein simply found the shares to still be within his custody, as Chief Executive Officer, and self-indulgently decided they should belong to him and/or to Trenton. He simply appropriated them for his own purposes (pp. 20-1, above).

More specifically, defendants contend that the bar of *res judicata* is applicable to all four categories of shares identified at pages of plaintiffs' brief. The evidence relating to these shares has been reviewed above. For the convenience of the Court, it is summarized here without further reference to the Transcript or the Exhibits.

(a) *The Trenton Original Issue Shares* (certificates A19527/56). These shares clearly do not come within the description of paragraph 22 of the prior complaint. In that litigation both Fein and Trenton were parties defendant. Paragraph 22 of the prior complaint complained of the issuance of stock "to third parties . . . for the benefit of said defendant". Obviously, the issuance of these 150,000 shares was not an issuance to third parties but directly to one of the two defendants named in the litigation.* Fein acknowledged that he should have cancelled these certificates in compliance with the intention of the Board of Directors.

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* The possible existence of these shares did not come to light until after October 6, 1966 (see Tr., 200-1) and Fein testified at trial he did not come into their possession until sometime in 1969 or 1970. (Tr. 622-3)

(b) *The Collateral Security Shares.* It is undisputed by the exhibits and by the testimony of Fein himself that these shares (500,000, not 550,000) were delivered to Trans as collateral security for the payment of the Anglo-Pacific note in the amount of $39,043.50. These shares were then sold almost a year later at a private unadvertised sale by Fein to Trenton. As the Court noted during the trial (Tr. 1268-9), plaintiffs' Exhibit 118 authorized Trans to retain these collateralized shares in the event of default by Anglo-Pacific. Clearly, Trans's rights of ownership in those shares and the sale of those shares by Fein do not come within the ambit of the allegations contained in paragraph 23 of the prior complaint. The transaction obviously was not one where Fein had a choice of acquiring these 500,000 shares for Trans or for his own benefit. The stock was already the property of Trans.

(c) *The Desilets Shares.* The issuance of these shares are entirely outside the parameters of the allegations contained in paragraph 22 of the prior complaint. That allegation dealt with the alleged wrongful issuance by Fein of stock to third parties for the benefit of Fein or Trenton. Plaintiffs did not contend or attempt to prove upon the trial that Fein "caused" the issuance of the Desilets shares. As a matter of fact, defendants acknuowledge that the shares were issued as part of a transaction affecting Marmot at a time "when Burkinshaw was in control of Transcontinental, ..." (Defendants' brief, 19-21). Plaintiffs have not claimed that the issuance of the Desilets stock was for the benefit of either Trenton or Fein. Paragraphs 16 and 17 of the complaint in the present action allege that the stock was never delivered to Desilets; that it remained the sole property of Trans; and that it was subsequently misappropriated by Trenton and Fein. In other words, the [illegible]ction alleged, in substance, that Fein had caused the [illegible]ce and sale of new Trans stock and pocketed the pro[illegible]. The second action charges Fein with having taken the stock (which he is not charged personally with having wrongfully issued) at a time when that stock was still the property of Trans (no consideration having yet been paid

for it and that stock still not having been delivered to Desilets) and converted that stock for the benefit of Trenton and Fein.

(d) *The August 12, 1960 Agreement Shares.* These are shares which expressly became the property of Trans (see Exhibits 17, 18, 19 and 20). Fein and Trenton have claimed that Trenton rightfully became the owner of that stock by reason of the Agreement they made, dated August 13, 1960 (def. ex. L). The self-serving provisions of that Agreement between self-dealing fiduciaries do not provide a lawful basis for the transfer of the ownership of that stock from Trans to Trenton. In any event, the transaction falls neither within the language of paragraph 22 or paragraph 23 of the prior complaint. Fein was not faced with having to choose whether the acquisition of these Trans shares should be for the benefit of Trans or for his own benefit. The documentary evidence is incontrovertible that the shares belong to Trans. The only issue was: did Fein have a right to take those shares and turn them over to Trenton?

POINT VIII

The affirmative defenses of limitations as to the first and second counts are without merit.

The pre-trial order describes the position of the plaintiffs with respect to the first and second counts (A 60, 75). The first and second counts clearly sound in conversion but also assert that the conduct of Fein and Trenton "constituted a breach of their fiduciary duties."

Defendants urge that the claims of Trans are barred by applicable Statutes of Limitations, whether under the earlier Civil Practice Act or under the later and current Civil Practice Law and Rules which became effective on September 1, 1963. The defendants are incorrect both on (a) the facts, and (b) the law.

The pertinent facts are merely capsulized here, having been more fully set forth at pp. 19-21, 28-33 above.

(1) The time of the occurrence of the conversion of the Trenton Original Issue Shares was never fully fixed upon the trial. If the defendants would assert the bar, it was for them to have fixed that date. Fein repeatedly testified that it was the intention of himself and the other Board members to cancel these shares. He assumed they had been cancelled. He did not become aware of their continued existence until *after* the litigation was started and his deposition was taken. He testified that sometime in or about 1969 he received the certificates from a former fiduciary and director, Mr. Robinson. How or when Mr. Robinson obtained possession was never explained by Fein.

(2) The Collateral Security Shares were not "acquired" by Trenton until the private, unadvertised and undisclosed sale made by Fein to Trenton in March 1961, less than six years from the time of the inception of the present litigation. Disclosure was never made by them.

(3) Likewise, as to the Desilets Shares, although they were "issued" (without consideration) to Desilets in 1960, they were never delivered to Desilets. How and when Fein first asserted dominion over these shares,—as opposed to being merely the repository of those shares upon delivery thereof to him by Buchman, the corporate counsel of Trans,—was not explained by Fein upon the trial. His testimony upon the trial and upon his earlier depositions was consistent in this singular respect, namely, that he did not become aware of the existence of these Desilets shares until after June 22, 1966.

(4) As to the so-called August 12, 1960 Agreement Shares, it is possible that such shares were indeed "delivered" to Trenton sometime in 1960 but knowledge of this transaction (as well as of the other transactions mentioned above) was withheld by Fein from the stockholders of Trans.

During the period in which Fein and Trenton managed Trans, shareholders were unable to secure information concerning the operation of Trans. No financial information or report was made to them after August 10, 1960 and that report dealt with much earlier events (Pl. Ex. 72 A 356).

Having insulated themselves against scrutiny during this period, these defendants now resort to the Statute of Limitations as a defense to the first and second counts. Trans contends that the Statute has not run because (a) the Statute expressly permits these counts to be maintained, and (b) the defendants are precluded from asserting the statutory bar.

§ 203(f) CPLR explicitly states that

> ". . . the time within which an action must be commenced is computed from the time when facts were discovered or from the time when facts could with reasonable diligence have been discovered, . . ."

In his "Practice Commentaries" to § 203 (McKinney's, CPLR § 203, p. 127), Dean Joseph M. McLaughlin states that the foregoing section applies "in any case where the running of the Statute of Limitations is postponed pending discovery."

It is undisputed that the acts of conversion and breach of fiduciary duties were concealed from the stockholders. Neither the fact of their commission nor the time of their commission were known to the independent successor management of Trans until the inception of the litigation and, to some extent, not even until the conduct of depositions and the actual trial herein.

Thus, as to any of the wrongful acts which occurred after September 1, 1963, it is clear that the Statute had not run until two years after discovery. *Friedman* v. *Myers,* 482 F.2d 435, 439 (C.A. N.Y. 1973).

Were there any merit in the contention that the pre-September 1, 1963 wrongful acts were barred by limitations, it is manifest that the defendants are precluded from utilizing such bar.

The New York rule tolls the Statute when it can be shown that a defendant, by some affirmative act, has concealed the very existence of a cause of action. Thus, though the period of limitations has run, the defendant is denied the benefit of it.

The absence of a direct misrepresentation by the controlling director does not necessarily make the Statute available to him. When the director stands in a fiduciary relationship to the complaining shareholder there is an affirmative obligation to make a full disclosure and the nondisclosure itself constitutes fradulent concealment. See Dawson, "Fraudulent Concealment and Statutes of Limitations", 31 *Mich. L. Rev.* 875, 887-893 (1933); Note, "Developments in the Law: Statutes of Limitations", 63 *Harv. L. Rev.* 1177, 1220-1222 (1950).

The Supreme Court has enunciated the doctrine that the maxim barring a man from taking advantage of his own wrong should preclude inequitable reliance on Statutes of Limitations. *Glus* v. *Brooklyn East. Term.*, 359 U.S. 231, 232-3, 79 S. Ct. 760, 762. This doctrine was cited with approval by the New York Court of Appeals in *General Stencils, Inc.* v. *Chiappa,* 18 N.Y.2d, 125, 272 N.Y.S.2d 337.

In *Erbe* v. *Lincoln Rochester Trust,* 13 A.D.2d 211, 214 N.Y.S.2d 849 (4th Dept., 1961), the beneficiaries of an estate, suing thirty years after testator's death, were permitted to maintain their cause of action though the Statute had tolled. The Court stated that in an action for breach of fiduciary relationship a trustee could not take advantage of the Statute when the beneficiaries of the trust may have been led by the trustee to believe that there was no breach of the relationship by statement of false facts or by concealment of the true facts. To the same effect is *Rank Organization Ltd.* v. *Pathe Laboratories,* 33 Misc.2d 748, 227 N.Y.S.2d 562 (Supreme Ct., Special Term, N.Y. Co., 1962) (95% shareholder estopped from asserting untimeliness of minority shareholder's objection to statutory merger and assertion of appraisal rights on ground that majority shareholder did not satisfy duty fully to disclose). See *Augstein* v. *Levey,* 156 N.Y.2d 594, at 599 (Supreme Ct., Special Term, N.Y. Co., 1956) (dicta).

The most explicit analysis of the New York approach is found in *Lowell Wiper Supply Co.* v. *Helen Shop, Inc.,* 235 F. Supp. 640 (S.D.N.Y. 1964). There, in a shareholders' derivative action, it was alleged that the controlling direc-

tors and officers concealed material facts, furnished misleading financial statements, and denied plaintiffs access to corporate books—all of which prevented plaintiffs from discovering that the corporation had entered into leases which inured to the benefit of directors and officers and injured the corporation. The Court denied the defendants the benefit of the Statute, relying on *Erbe* v. *Lincoln Rochester Trust Co., supra* and *Rank Organization Ltd.* v. *Pathe Laboratories, Inc., supra.* The Court noted the position of New York courts in refusing the benefit of the Statute to a fiduciary who has concealed the fact of his wrongdoing. It pointed out that New York courts apply the doctrines of fraudulent concealment and equitable estoppel interchangeably in denying resort to the Statute.

The precise issue involved in the instant litigation was considered in *Standard Kollsman Industries, Inc.* v. *Sphere Brokerage, Inc.,* N.Y.L.J., November 21, 1966, (Sup. Ct., N.Y. Co., Helman, J.). There, the complaint alleged that the corporation's former chief counsel, director and chief executive officer had over a period of years entered into various schemes to unjustly enrich himself and others in breach of his obligation as a fiduciary. Some of the wrongs had occurred as early as 1952. Special Term noted that the doctrine of equitable estoppel denies to a fiduciary who fraudulently conceals a breach of his obligations the right to invoke the Statute of Limitations as a defense, aff'd 282 N.Y.S.2d 921.

The vitality of this New York doctrine of equitable estoppel was given recognition in *Saylor* v. *Lindsley,* 302 F. Supp. 1174 (D.C. N.Y. 1969).

C. The Counterclaims of Defendants

The pertinent facts

It would appear that the first and second counter-claims are predicated upon statements contained on page 57 of defendants' brief which, in substance, assert that "upon assuming control" of Trans, Sackett refused to permit the transfer of shares owned by Trenton as part of a plan to re-negotiate the terms of the August 12, 1966 Agreement.

These assertions are at variance with the facts and with the testimony adduced upon the trial. For one thing, the "stop-order" was not issued until October 6, 1966,—almost two months after the surender by Fein to Sackett of control over Trans. If there were ever a conspiracy, as asserted by the defendants, to accomplish the purposes alleged in the counterclaims, there was a signal failure on the part of the plaintiffs to implement the alleged conspiracy and suit action to their alleged word because they did nothing to advance the purposes of the purported conspiracy during the entire period from August 12, 1966 to October 6, 1966.

Insofar as the Ninth Cause of Action by Sackett, individually and on behalf of his associates, sought to compel the defendants to deliver *all* of the Trans shares held by Trenton, instead of merely 650,000 shares, this was not an effort on the part of Sackett to "re-negotiate" the terms of the Settlement Agreement but rather to compel compliance with the Agreement between the parties and the provisions upon which settlement was had in this United States District Court before Judge Harold R. Tyler in 1966.

The negotiations of the terms of the settlement were first explored at a meeting in October 1965. From the very outset, the basis of the settlement was the transfer of Fein's and Trenton's entire position in Trans to Sackett. This necessarily involved the sale to Sackett of all of the stock which Trenton had acquired (Tr., p. 53). While Fein may have proposed an asking figure of some $280,000, at no time was such a figure considered by Sackett and no further direct discussions or negotiations were had between them thereafter. All the material and terms of the settlement were thereafter negotiated by Paulson and Taylor. There is no credible evidence whatsoever in the record that Sackett ever advised Fein that he had difficulties in raising the necessary funds to liquidate the position of Trenton and Fein in Trans. The contract price of $187,500 represented the maximum amount that Sackett was willing to pay for that position in a shell company which Fein conceded was then insolvent.

The record is replete with Sackett's references to detailed notes which he had kept of his conversations, both direct and telephone, with Fein (Pl. ex. 49; Pl. exs. for ident. 50, 130; Tr. 53 et seq. His account of events was fully supported by the affidavit of Irwin M. Taylor, dated June 22, 1966, and which was presented to this Court in connection with the settlement of the prior derivative action (Def. ex. C). On the other hand, Fein had not one single written note or memorandum to support his contentions of there having been any further direct negotiations between him and Sackett after their initial exploratory meeting of October, 1965. He conspicuously refrained from calling his own attorney Milton Paulson, Esq. to corroborate his contentions. The unexplained absence of Milton Paulson is in fact a disclaimer of the reliability of the testimony of Fein and becomes further corroboration of the position asserted by Sackett.

Insofar as the reference in the defendants' brief to the absence of any explicit representation by Fein to Sackett that Trenton only owned 650,000 shares of Trans stock, Sackett acknowledged the fact he did not believe that Fein had ever made any such direct representation to him. This is not at all inconsistent with the position which has been steadily urged by Sackett, namely, that the negotiations were carried on not by Fein personally but by Paulson on his behalf.

Finally, as to the first and second counterclaims, it is clear that at no time did Sackett or Trans ever interfere in the transfer of any shares registered in the name of Fein. Fein's own tax return for 1966, Schedule D (Pl. Ex. 120), reveals that after the conclusion of the transaction with Sackett on August 12, 1966, he was able to sell 83,900 shares of his own personally-held stock, without any interference whatsoever by Trans. The interference by Trans with the transfer by Fein of any stock relates solely and exclusively to stock which was the subject of proper and rightful refusal by the Corporation.

As to the third counterclaim, it is evident from defendants' brief, as well as from the evidence upon the trial, that

the defendants have neither attempted nor succeeded in proving any 10(b)5 violation by Sackett and/or the Additional Defendants.

Neither on the facts nor on the law is any judgment warranted in favor of Trenton and/or Fein on any of the three counterclaims which are asserted by them in this litigation.

POINT IX

The First and Second Counterclaims were properly dismissed.

The crux of the first and second counterclaims is the contention that the refusal of the Corporation to permit the transfer of the shares of stock identified in the stop-order was a tortious interference with the rights of the defendants.

The plaintiffs have no quarrel with the basic principle that a stockholder has the right to have the corporation in which he owns stock transfer that stock pursuant to his instructions. This principle, however, is subject to limitations. The corporation has the duty, *rightfully,* to refuse to permit the transfer of stock where there are adverse claims to that stock.

In the case at bar, the stockholder in the transfer was not some outside distant stockholder whose conduct vis-a-vis his corporation was not the subject of concern or the cause of any injury to that corporation. For the purpose of these counterclaims, Trenton and Fein may be regarded as a single fiduciary, whose stock (1) had been issued without consideration and was, therefore, void, or whose stock (2) should have been cancelled by the same fiduciary, or whose stock was (3) converted by that fiduciary from Trans. The facts and the law delineating the deficiencies of that stock have been more fully explored in other parts of this brief.

The very cases cited by the defendants in support of their position clearly and unqualifiedly stand for the proposition that, where there are adverse claims of which a corporation has knowledge, the corporation has the right to bar the transfer of the stock. Even beyond that right, *per se,* other authoritative cases hold that there is a *duty* which rests upon the corporation to protect its stockholders of record against unauthorized and fraudulent transfers.

> "There is no doubt that a corporation is a trustee of its stockholders, and is bound to proper vigilance and care that they may not be injured by unauthorized transfers of their stock." *Leff* v. *Kaufman,* 20 A.2d 786, 139 ALR 267.

Beyond the reasons stated above, which themselves are persuasive as to the legal deficiencies of the stock which Trenton and Fein sought to transfer, there is the further circumstance that, on the basis of the representations made by Trenton and Fein to Sackett, there was an apparent overissue of stock. The representations contained in the June 22, 1966 Agreement between Sackett and Fein expressly stated that the number of shares of Trans stock then outstanding did not exceed 3,600,000 shares. It was only when Sackett learned, immediately prior to October 6, 1966 that the number of shares actually outstanding was 3,977,600 shares, that the stop-order was issued (Tr. 1366-9; Pl. Ex. 128).

The defendants contend that there were four categories of certificates which were wrongly stopped, namely:

1. Certificates A19527/56 for 150,000 shares (identified in plaintiffs' main brief as the "*Trenton original issue shares*"). These are the shares which Fein repeatedly admitted on trial were shares which the Board had intended to cancel and he believed had been cancelled by reason of the fact that Green, on behalf of Trenton, wanted shares which were unrestricted and readily saleable. In place of these 150,000 shares, the Trans Board agreed to deliver 141,000 treasury shares (the so-caled "Brown" shares) and 9,000 shares to be newly issued. The nullity of certificates A19527/56 has been fully reviewed hereinabove and the Court is now respectfully referred thereto again. It is reminded also that Fein did not even discover he had these shares in his possesion until sometime in 1969 or 1970 when they were delivered by Mr. Robinson as part of some file of papers that was being thrown out following the death of Mr. Green (Tr. 200-1, 622-3).

2. Certificates B6456/58, B6389/91, B6431 and B6392/-404, aggregating 100,000 shares, were the shares which came out of the so-called "*Desilets shares*", certificates A19557/76. The Court below has found these Desilets shares to have been converted by defendants.

3. Certificates B6571/98 and B6599/6600, amounting to 150,000 shares, were issued by Fein *after* August 12, 1966 in exchange for the surrender of Certificate A20327 which had been registered in the name of Elsie Chamberlain (being part of the 350,000 shares identified herein as the "*August 12, 1960 Agreement Shares*"). Trans's right to stop the further transfer of the foregoing shares will be explored below.

4. Certificates B6714/16, B6718/21, B6723/35 and B6736/45, aggregating 150,000 shares, were issued by Fein after August 12, 1966 in exchange for certificates A20084 and A20083. The latter two certificates were themselves issued in 1960 in exchange for certificates A19620 and 19625 (identified in plaintiffs' main brief as the "*Trenton-Anglo Purchase Shares*"). Trans's right to stop the further transfer of the foregoing shares will be explored below.

The right of an owner to have his shares of stock transferred on the books of the corporation is a matter which relates to the internal affiairs of a corporation and is governed by the laws of the state of incorporation. *Gordon Holdings, Limited* v. *Mohawk Bus. Mach. Corp.*, 13 Misc.2d 1024, 1044, 179 N.Y.S.2d 33.

Although it appears that there is no Delaware case specifically in point (and none has been cited by the defendants), the general rule in the various jurisdictions holds that a stockholder has the right to have the Corporation, in which he owns stock, transfer that stock in accordance with his directions, 139 ALR 267, UCC § 8-401, but without exception such right is respected and enforced only in the absence of an adverse claim. *Kanton* v. *United States*

Plastics, Inc., 248 F.Supp. 353 (D.N.J. 1965). In the latter case, cited by defendants, the Court stated:

> "The general rule is that a corporation may refuse to register a transfer of stock when it has reasonable grounds for doing so, but it must act in good faith and present some adequate reason for its refusal, and support such refusal by evidence. [citing authorities] Notice of an adverse claim to the stock sought to be transferred is a reasonable ground for temporarily refusing to register the transfer." (p. 362)

The two groups of shares described in paragraphs 1 and 2 above (the *"Trenton Original Issue Shares"* and the *"Desilets Shares"*) were shares which were so glaringly deficient in their right to claim transferability that the action of the Corporation in stopping the transfer of those shares cannot be seriously challenged. The exercise of its right of refusal to register those shares in particular rests comfortably on reasonable grounds and the actions of the Corporation, in that respect, were entirely in good faith,—well within the general rule enunciated above,—and Judge Conner below so determined (A 143).

The Corporation's stoppage of the transfer of the shares of stock referred to in paragraphs 3 and 4 above (the "August 12, 1960 Agreement Shares" and the "Trenton-Anglo Purchase Shares") requires further analysis.

Certificate A20327 for 150,000 shares was part of the so-called "August 12, 1960 Agreement Shares." As Plaintiff's exhibits 17, 18, 19 and 20 indicate, this certificate was transmitted by Anglo-Pacific's attorneys to Buchman & Buchman who then delivered it to Fein. Such delivery was pursuant to the terms of the August 12, 1960 Agreement (Pls. Exs. 17 and 118). Under the terms of that Agreement, the stock became the property of Trans. Fein's right to transfer that certificate to Trenton rests upon his claim that this certificate became the property of Trenton by reason of the terms of a letter, dated August 13, 1960, from Fein to Green (Def's. Ex. L), a letter which defendants produced for the first time only after the litigation herein was com-

menced. The efficacy of that letter was challenged by Trans and was an issue upon the trial because Trans contended it was a device by faithless fiduciaries to effect a secret self-serving arrangement between themselves in derogation of their duties to Trans and the rights of its shareholders. Trans has urged that the transfer of these shares was a conversion by the defendants.

Moreover, assuming *argendo* that the transfer by Trans to Trenton of certificate A20327 was proper and fair, then this certificate along with the other certificates which were rightfully acquired by Trenton would have aggregated the 650,000 shares which Trenton had agreed to deliver to Sackett under the June 22, 1966 Agreement. Thus, in either case, certificate A20327 should have remained the property of Trans or should have been transferred by Trenton to Sackett pursuant to the aforesaid Agreement of June 22, 1966. Consequently, there was an adverse claim to certificate A20327 by Trans itself as well as by Sackett. Therefore, Trans was justified and acted in good faith in stopping certificates B6571/98 which were issued by Fein in exchange for certificate A20327. Moreover, Fein was not authorized to issue such certificates after August 12, 1966. He had ceased to be the President. He was authorized by Sackett only to complete the processing of existing transfers (Pls. Ex. 120; Tr. 1354-7).

While Trans has not disputed Trenton's right to have acquired the so-called "Trenton-Anglo Purchase Shares" from which the certificates itemized in paragraph 4 above were derived, Trans was wholly justified in stopping the transfer of the latter certificates. The Trenton-Anglo Purchase Shares were exchanged in 1960 by Trenton for certificates A20083 and A20084. Not until after August 12, 1966 did Fein exchange these certificates for the ones itemized in paragraph 4 above which were registered in the name of Herzfeld & Stern and in the name of Gerstley, Sunstein & Co. Fein admitted upon the trial that he did not prepare, execute and deliver these certificates until after August 12, 1966 (Tr. 1354-7) when, as indicated above with respect to the so-called "August 12, 1960 Agreement Shares," he no longer had the authority to act.

Likewise, these are the shares which Trenton should have delivered to Sackett under the June 22, 1966 Agreement. He had an adverse claim to these shares and the propriety of that claim is one of the issues in this litigation. Moreover, there is the circumstance that Trenton and Fein used converted stock, the so-called "Collateral Security Shares" (certificates A19616/18; A19622/3 for 500,000 shares) to meet their contractual obligation to Sackett instead of delivering to Sackett certificates A20083 and A20084.

Finally, the discovery by Sackett immediately prior to August 6, 1966 that the number of shares issued and outstanding was not a maximum of 3,600,000 shares,—as expressly warranted by Trenton and Fein, but rather 3,977,000 shares, clearly justified the issuance of a stop-order against the particular shares in dispute here. The failure on the part of Trans to have exercised such a right of refusal to stop the transfer of these shares would have been a dereliction of the duty which Trans owed its stockholders and would have licensed Fein and Trenton to profit from their own wrongdoing. Unless that right of refusal was exercised, Trenton and Fein would have been enabled to introduce into the trading market not only the shares which they had rightfully owned but also those shares they obtained through the breach of their fiduciary duties. Having already transferred out of their possession the "Collateral Security Shares" and the "Desilets Shares", and denying knowledge of the location of the "Trenton Original Issue Shares" (Tr. 200-1, 622-3), their efforts to sell the shares derived from certificates A20327, 20083 and 20084 had to be barred. If that step were not taken, converted and void certificates would be outstanding in the hands of the public,—all to the harm of the thousands of Trans stockholders and all to the profit of the self-dealing fiduciaries.

Riskin v. *National Computer Analysis, Inc.*, cited by defendants, involved the refusal of a corporation to transfer such shares where the stockholder had obtained an SEC "no action" letter. A finding was made that the refusal to transfer the shares was motivated by bad faith. A similar

fact situation existed in *Gasarch* v. *Ormand Industries Inc.*, likewise cited by defendants. In both these cases, the corporation was held to be liable because the refusal in each instance was in bad faith and absent a valid reason for failing to permit the transfer. In the case at bar, good and substantial reasons justified the refusal of Trans to permit the transfer of the shares upon which defendants have sought relief in their first and second counterclaims.

The *Kanton* case also involved the refusal of a corporation to permit the transfer of shares after the shareholder obtained an SEC "no action" letter. The Court held in favor of the plaintiff but recognized that a corporation may refuse to effect such transfer when there is an adverse claim asserted against that stock which is substantial in nature (at pp. 362-3). Such was the situation with respect to the affected stock in the case at bar.

The *Rothberg* case, cited by defendants, involved only a motion to dismiss because the complaint failed to state a claim upon which relief could be granted, pursuant to FRCP 12 (b)(5). The Court merely found that the plaintiff had stated a claim under the antitrust laws for alleged conspiracy. Such is not the situation in the case at bar.

POINT X

The Third Counterclaim was properly dismissed.

In the third counterclaim, neither the facts nor the law support the position urged by defendants. If there were ever any intention on the part of plaintiff Sackett and the "Additional Defendants" to prevent Trenton and Fein from selling their shares, it is strange indeed that no steps were taken to implement this intention in the entire period from August 12, 1966 to October 6, 1966. Contrary to the purported objective of the alleged conspiracy, the stable door was left wide open for Fein to sell his shares; he did sell all of his personal 83,900 shares in that period of time (pls. Ex. 130) and Trenton sold other shares as well.

Despite the assertion of defendants that Sackett and the "Additional Defendants" were selling their shares while barring the defendants from the sale of their own, the facts are clearly otherwise.

	Date of Sale	*No. of Shares Sold*	*Def. Ex. No.*
B. Edwin Sackett	3/17/67	14,000	FFF
	12/5/73–1/30/74	10,000	FFFFF
Phillip P. Goodkin	12/15/66–10/25/68	23,600	DDD
	9/23/74	1,400	XXXX
Louis Goodkin		None	
Michael A. Roberts		None	
David Frankel	[assigned to Fagenson and Frankel, Inc.]		HHH
James E. Davis		None	BBB
Paul A. Rossborough		—	—
J. Streicher & Co.		None	CCC
Harry B. Leslie Renee Leslie	7/9/66–10/24/68	57,610	EEE
Bertram F. Fagenson	1/68	5,500	ZZZZ, AAAAA
Jerome Frankel	1/68	5,500	
Fagenson & Frankel, Inc.		None	

Such sales as were made were incidental and relatively nominal in terms of the gross number of shares owned by the "Additional Defendants."

From the foregoing, it is clear that the claim of an alleged conspiracy is without any foundation in fact:

1. The shares acquired from Trenton and Fein were treated by Sackett and the Additional Defendants as restricted shares and were not sold at all by them until many years later.

2. The only shares sold by either Sackett, Phillip P. Goodkin, the Leslies, Fagenson or Jerome Frankel, within two years of the transaction with Trenton and Fein, were shares they had acquired long before the transaction with Trenton and Fein.

3. Very few of the shares acquired by Sackett and the Additional Defendants were ever sold at all, even down to the time of trial. J. Streicher & Co., who acquired 50% of all the shares purchased by the syndicate from Trenton and Fein, had never

> sold any of such shares. No sales had ever been made by Louis Goodkin, Roberts, Davis, Fagenson, David Frankel, Jerome Frankel or Fagenson & Frankel, Inc. of any of the shares acquired by them as members of the syndicate. If there were a conspiracy, as alleged by the counterclaiming defendants, it is strange that only some of the alleged conspirators should have attempted to profit from that alleged conspiracy and, then, only to a minimal extent. The fact of a conspiracy is belied by the actual conduct of the alleged conspirators.

The facts in the case at bar do not provide any foundation whatsoever for the application of either Section 10(b)5 or the two cases cited by the counterclaiming defendants, *Mariash* v. *Morrill* or *Rothberg* v. *National Banner Corporation.* The *Mariash* case involved merely a motion to dismiss a complaint where the plaintiff alleged manipulation in that the defendants allegedly sought to reach the market with their stock before the plaintiff could. On the motion, the Court construed the complaint liberally, as it was required to do, and merely sustained the complaint. In the case at bar, there is no proof whatsoever of any manipulation or that Sackett and his associates had any interest whatsoever in trying to sell their stock. Their acquisition of Trans stock from Trenton and Fein was clearly for the purpose of taking a shell of a company and building it into a viable entity. They succeeded in doing just that. The facts clearly reveal that there was no intention whatsoever on the part of Sackett and his associates to sell their shares and, in the eight years which elapsed between the time of the transaction and the time of trial, only a relatively insignificant number of shares were sold by Sackett and his former associates. Such few sales were independently made by the individual selling stockholder without regard to any alleged scheme or conspiracy.

The *Rothberg* case, cited by defendants, simply has no application to the facts of the instant case.

To support a successful 10(b)5 action, the undisclosed or alleged misrepresented facts must be material. That is

to say, the misrepresented or undisclosed facts must be objectively important in determining the fairness of the price and actually relied on by the seller in accepting the offer. *List* v. *Fashion Park Inc.*, 340 F2d 457 (2nd Cir., 1965), *cert. den.*, 382 US 811 (1965); *Janigan* v. *Taylor*, 344 F2d 781 (2nd Cir., 1965), *cert. den.*, 382 US 879 (1965); *Voege* v. *American Sumatra Tobacco Corp.*, 241 FS 369 (D. Del., 1965).

The test of "materiality" is whether "a reasonable man would attach importance [to the fact assertedly misrepresented] in determining his choice of action in the transaction in question." *List* v. *Fashion Park Inc., supra; SEC* v. *Texas Gulf Sulphur Co.*, 401 F2d 833 (CA 2nd, 1968); *SEC* v. *R.A. Holman & Co.*, 366 F2d 456 (CA 2nd, 1966). The Courts have frequently cited *Kohler* v. *Kohler Co.*, 319 F2d 634 for the definition of "materiality" as encompassing those facts which, in reasonable and objective contemplation, might affect the value of corporate stock or securities (at p. 642).

Fein claims, as indicated above, that he expressly asked Sackett whether Mr. Leslie was part of the purchasing group. Sackett denied that any such inquiry was made and points to the fact that his last conversation with Fein, before the signing of the contract on June 12, 1966, was during the exploratory meeting of October 1965. At that time, the litigation was still pending and Sackett had not yet begun to even contemplate the formation of a group of investors to buy out the position of Fein and Trenton in Trans. But even, assuming that Fein had asked whether Leslie was part of the buying group and Sackett had deliberately deceived him, there is nothing in the record to indicate that Fein at the time of the alleged inquiry placed any significance upon Leslie being one of the putative purchasers or that he would refuse to make the deal with Sackett if, in fact, Leslie were one of those purchasers.

Considering the financial circumstances of Trans, its moribund state and its complete lack of prospects for any future success, one may fairly inquire whether Fein would have been influenced to act differently if he had known that Leslie was to be one of the purchasers. Why should

Fein have cared at all if Trenton and Fein were to be paid completely in cash for their stock? Even the stock that Fein wrongfully withheld from Sackett was stock that he planned immediately to sell. At least that is the contention that underlies his first and second counterclaims. If that be so, what difference would it have made to him that Leslie should have had any subsequent affiliation, even as only one participant in a group of investors constituting the purchasing syndicate? In the *List* case, cited above, the Court held that a seller of stock was not damaged under Section 10 (b)(5) where it was found that he would have sold even if he had known that one of the buyers was a director of the corporation. Accordingly, the Court held that the seller failed to establish the elements of reliance and materiality.

Moreover, it has also been held that *conscious* fraud is a necessary element of a claim under Rule 10 (b)(5); material misrepresentation alone does not suffice. *Thiele* v. *Shields,* 131 FS 416 (SDNY, 1955); *Elis* v. *Carter,* 291 F2d 270 (2nd Cir., 1961).

Finally, the facts themselves establish the entire vacuity of the counterclaim here asserted by the counterclaiming defendants.

Fein failed to produce any note or memorandum of any kind in support of his claim of the alleged fraudulent misrepresentation concerning Leslie nor did he call his own attorney, Milton Paulson, Esq., to corroborate his statement. There was absolutely nothing in the record to support any contention of Leslie's prior association with any persons who had defrauded Trans or with other persons with bad business reputations. It appears that Fein himself had been a money lender to Lowell Birell (Tr. 784). In any event, the Court itself expressly advised counsel that the testimony with respect to Birell was wholly irrelevant and was to be disregarded (Tr. 785-7; 1123).

Mr. Leslie testified at length that whatever contacts he had with Burkinshaw were limited, temporary and came only through Fein himself. Leslie had nothing whatsoever

to do with any of the transactions between Trans and Burkinshaw. He resigned in November of 1965 (pls. Ex. 40B) prior to any of the transactions between Trans and Burkinshaw. He had nothing further to do with the affairs of Trans in any directorial or other official capacity (Tr., pp. 1100-1125).

Finally, the record is devoid of proof of (a) any intention on the part of Sackett and the Additional Defendants to manipulate the price of Trans stock; (b) any manipulation in fact or (c) that they succeeded in maintaining the price of that stock at artificial levels. What is evident and uncontroverted is that Sackett and his associates took an insolvent shell of a company and made it into a viable and substantial operating company with valuable assets. This success was accomplished by the investment by Sackett and his associates of substantial capital and, so far as Sackett himself was concerned, the investment of many years of service as an officer and director of Trans (pl. Ex. 129; Def. Ex. UUUU).

CONCLUSIONS

The Order and Judgment below should be:

a. Affirmed as to Count 2;

b. Reversed as to Counts 1, 9 and part of 10; and

c. Affirmed as the dismissal of defendants' counterclaims.

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